IMF Programs in Emerging Europe. View on Hungary

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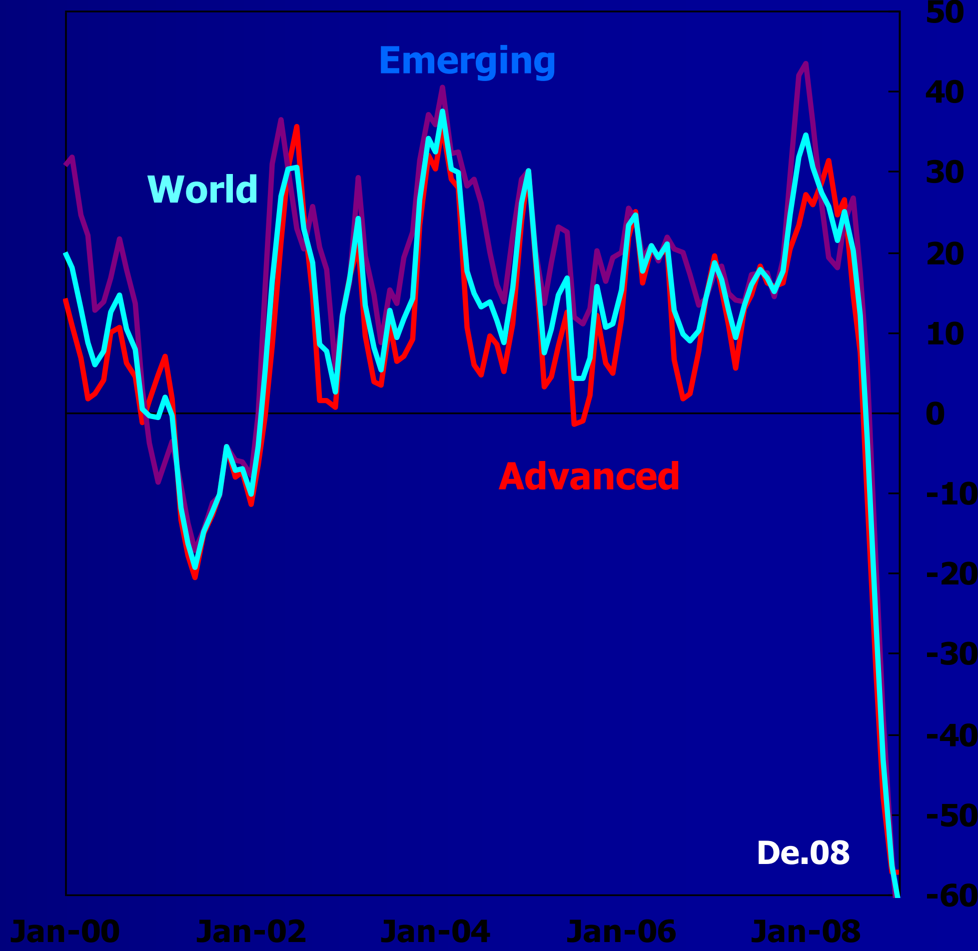
October 14, 2011, Budapest

Crisis Backgrounder

- Financial crisis (August 2007)
  - "Growth crisis" (Fall 2008)

Merchandise Exports
(Annualized percent change of 3mma over previous 3mma)



Crisis Backgrounder: Emerging Europe Hard Hit

– Tight cross-European linkages, financial linkages
– Rapid demand-led growth in most countries, financed by capital inflows
– Sudden stop to capital inflows, trade linkages collapse:
  - No growth
  - Stresses the financial system; on balance sheets as currencies depreciate

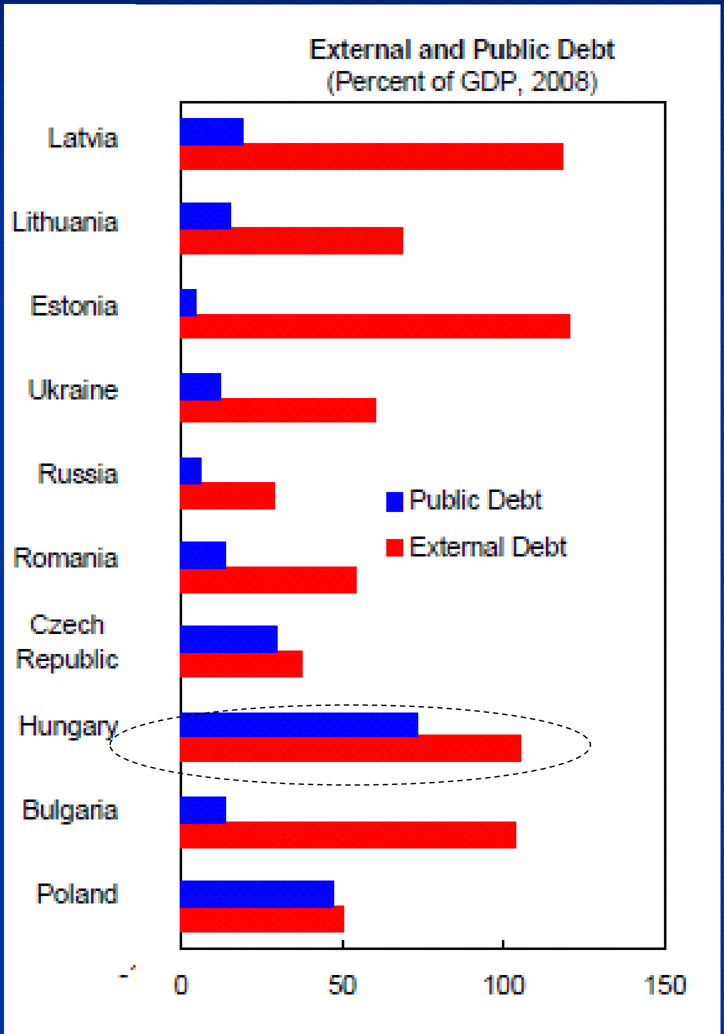
Crisis Severity: Function of Vulnerabilities

Vulnerabilities →

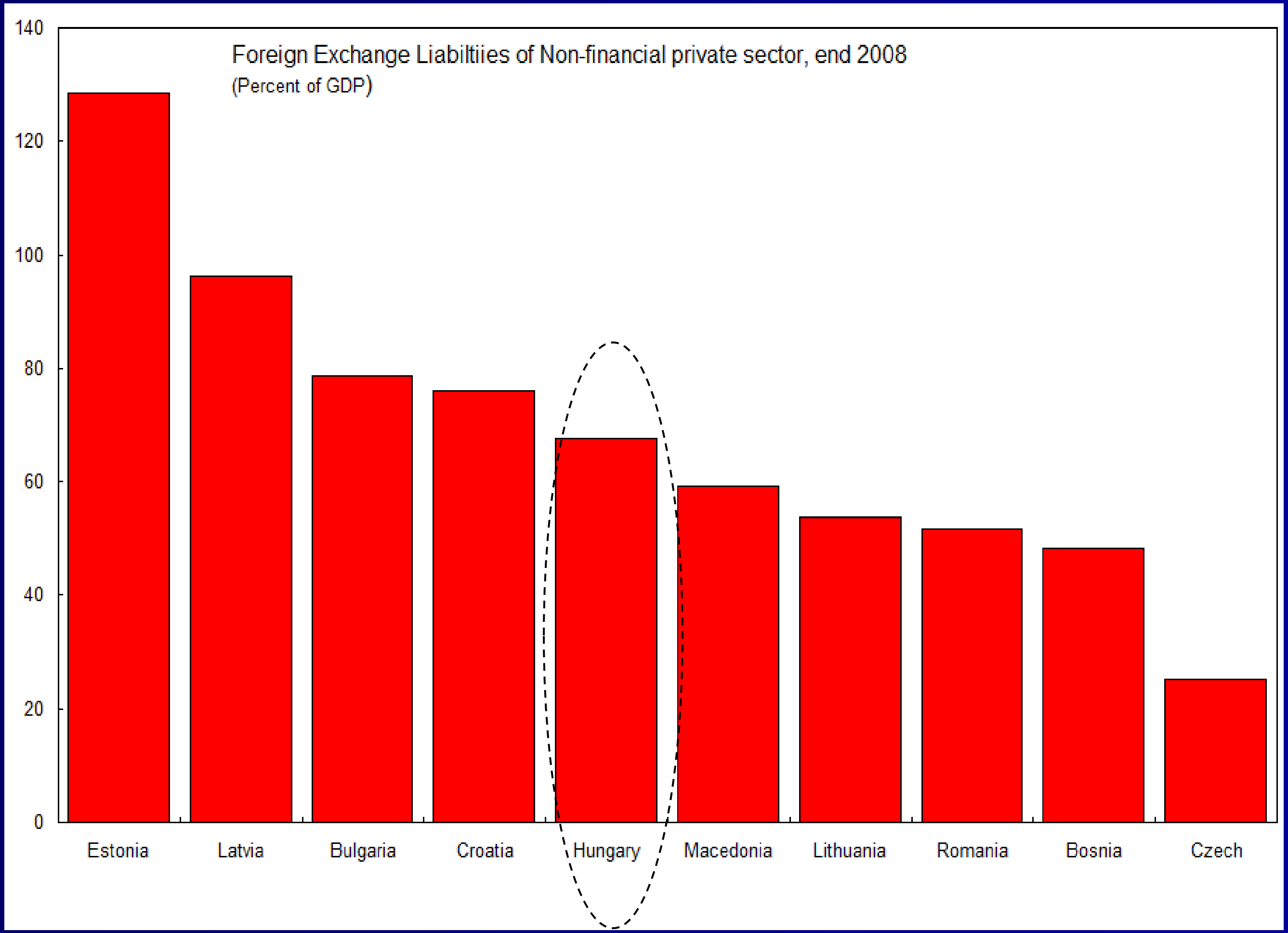
limited room for policy responses

Public finances, FX debts,

local asset price bubbles, remittances



Emerging Europe Crisis Severity: Function of Vulnerabilities



Crisis Response: IMF Part

- About USD 75bn of total new programs in EME
- 250 bn SDR allocation to boost global liquidity:
  - SDR 100 billion to emerging markets, SDR 991 million to Hungary
- G-20 strengthen the IMF (London, April 2009)
  - Tripling recourses to $750 billion
  - Additional concessional lending to low-income countries

Crisis-Response: IMF Part

Member	Type of Arrangement	Duration of Arrangement	Amount Agreed (SDR millions)	Amount Drawn (SDR millions)
Ukraine	SBA	11/05/08 - 07/27/10	11,000	7,000
	SBA	07/28/10 – 07/27/12	10,000	2,250
Hungary	SBA	11/06/08 - 10/05/10	10,538	7,637
Latvia	SBA	12/23/08 - 12/22/11	1,522	982
Belarus	SBA	01/12/09 - 03/30/10	2,270	2,270
Serbia	SBA	01/16/09 - 4/15/11	2,619	1,321
Romania	SBA	05/04/09 - 03/30/11	11,443	10,569
	SBA	03/31/11 – 03/30/13	3,091	0
Bosnia and Herzegovina	SBA	07/08/09 - 06/30/12	1,015	338
Poland	FCL	05/06/09 - 05/05/10	13,690	0
	FCL	07/02/10 – 01/20/11	13,690	0
	FCL	01/21/11 – 01/20/13	19,166	0
Moldova	ECF/EFF	01/29/10 - 01/28/13	370	120

Crisis Response: IMF's substantial co-financing for EU members

Member	Total Financing	IMF	EU	World Bank, EBRD, and bilaterals
Hungary	€ 20 billion	€ 12.3 billion (61 percent)	€ 6.5 billion (33 percent)	€ 1.2 billion (6 percent)
Latvia	€ 7.5 billion	€ 1.7 billion (23 percent)	€ 3.1 billion (41 percent)	€ 2.7 billion (36 percent)
Romania	€ 19.9 billion	€ 12.9 billion (65 percent)	€ 5 billion (25 percent)	€ 2 billion (10 percent)

Crisis Response: New Tools

- FCL: crisis-prevention and mitigation tool (introduced March 2009)
  - Unrestricted renewability
  - For countries with robust policy framework and strong track record in economic performance
  - No cap on access
  - Used, but not drawn, by Poland, Mexico, and Columbia

- PCL: an "FCL-lite":
  - For countries with moderate remaining vulnerabilities
  - Strong policies to reduce vulnerabilities

Crisis Response: Program Design

Objectives: shore up confidence, reduce pain, smooth adjustment, ensure long-term sustainability, protect vulnerable, :

- Large, front-loaded financing
- Financing to create policy space:
  - Facilitate deficit spending
  - Support currencies / avoid excessive depreciation
  - Support/restore financial stability
- Involve stakeholders: “Vienna Initiative”

Program Design: Tailored to Country-Specific Vulnerabilities

- Fiscal policy: public debt sustainability, ER policy, external adjustment need, financing constraints
- Monetary policy: risk premia, exchange rate pressure, inflation outlook
  - Currency depreciation: country preferences, competitiveness, balance sheets, income policies, economic flexibility
- Financial sector policy: degree of stability, confidence-building

Hungary SBA: Crisis-Response

Objective: put a floor for investor confidence, avoid more severe crisis, give room for policy:

- **Large**: EUR 12.5 bn from IMF (6.5 bn from EU)
- **Front-loaded**: first tranche EUR 4.9 bn
- **Targeted**: two goals
  - Achieving fiscal sustainability: deficit targets, quality structural measures
  - Maintaining financial stability: reserves, bank safety net, coordination initiative
- **Flexible**:
  - Deficit target revised up by 1.3% of GDP in 2009 in response to worse outlook

Hungary SBA: Taking Stock

- 1st -5th Reviews: completed by March 24, 2010:
  - Drawn app. EUR 9 bn (>70% of all SBA)
  - Did not draw EUR 1.7 bn at 4th and 5th reviews:
    - Re-gained market access: HUF and FX
    - better financing environment and consistent national policies
      - Structural fiscal adjustment 3% of GDP in 2009
      - Strengthening financial supervision
- SBA expired October 5, 2010
  - 6th & 7th Review: not completed. App. SDR 3bn of undrawn funds would have been an insurance against deterioration in global financial environment.

Program Performance

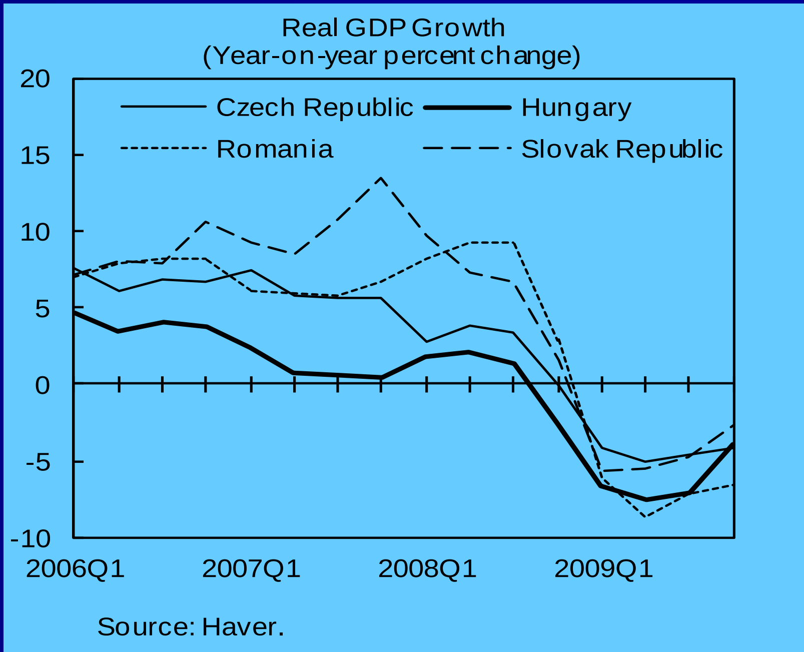
- Exchange rate overshooting avoided:
  - pegs preserved in Latvia, Bosnia and Herzegovina
  - depreciation contained in Hungary, Romania, Serbia
- Smaller external adjustment
- Nominal interest rate spikes avoided
- Inflation contained
- Banking crises avoided: these are costly!

Hungary SBA: Crisis-Response

Not easy measures, but likely better than counterfactual:

- Smaller currency depreciation
- No large-scale defaults
- No banking crisis: costly
- Possibly better growth outcome,

less adjustment

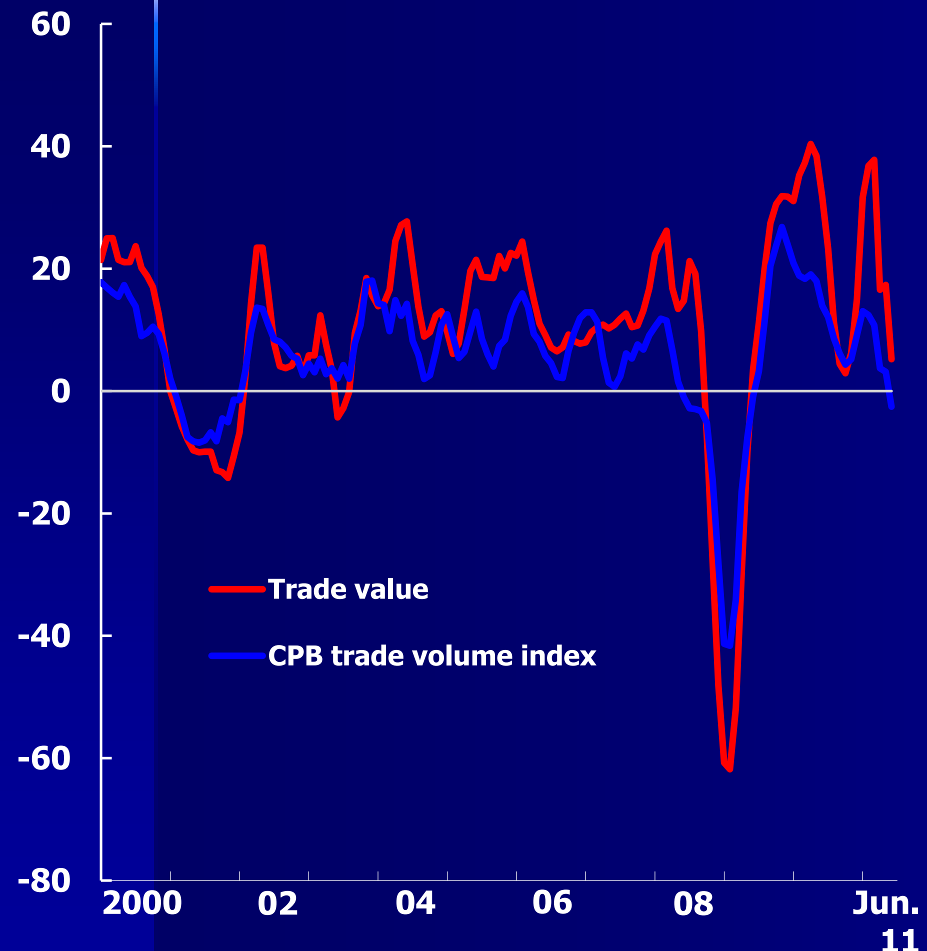


CEE: Challenges Ahead

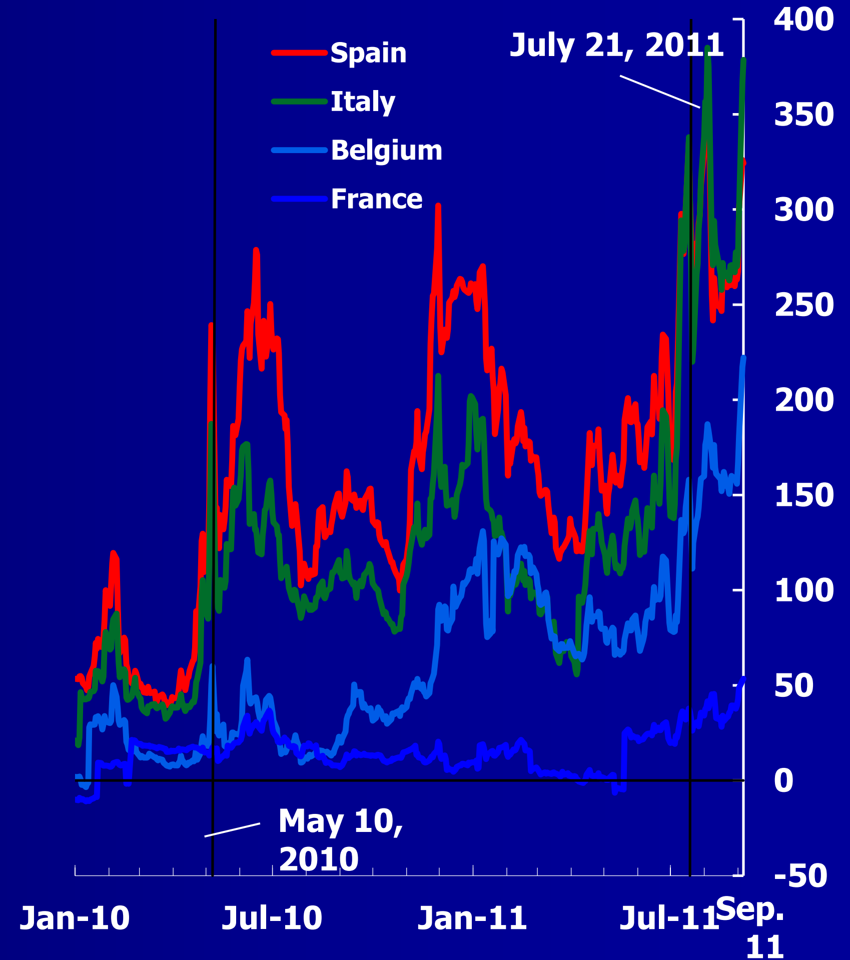
- Complete started adjustment and reforms
- Navigate through:
  - weaker global growth outlook
  - higher financial volatility
- Find sustainable growth model for longer-term

Challenging Outlook: Slower Global Growth and Higher Financial Volatility

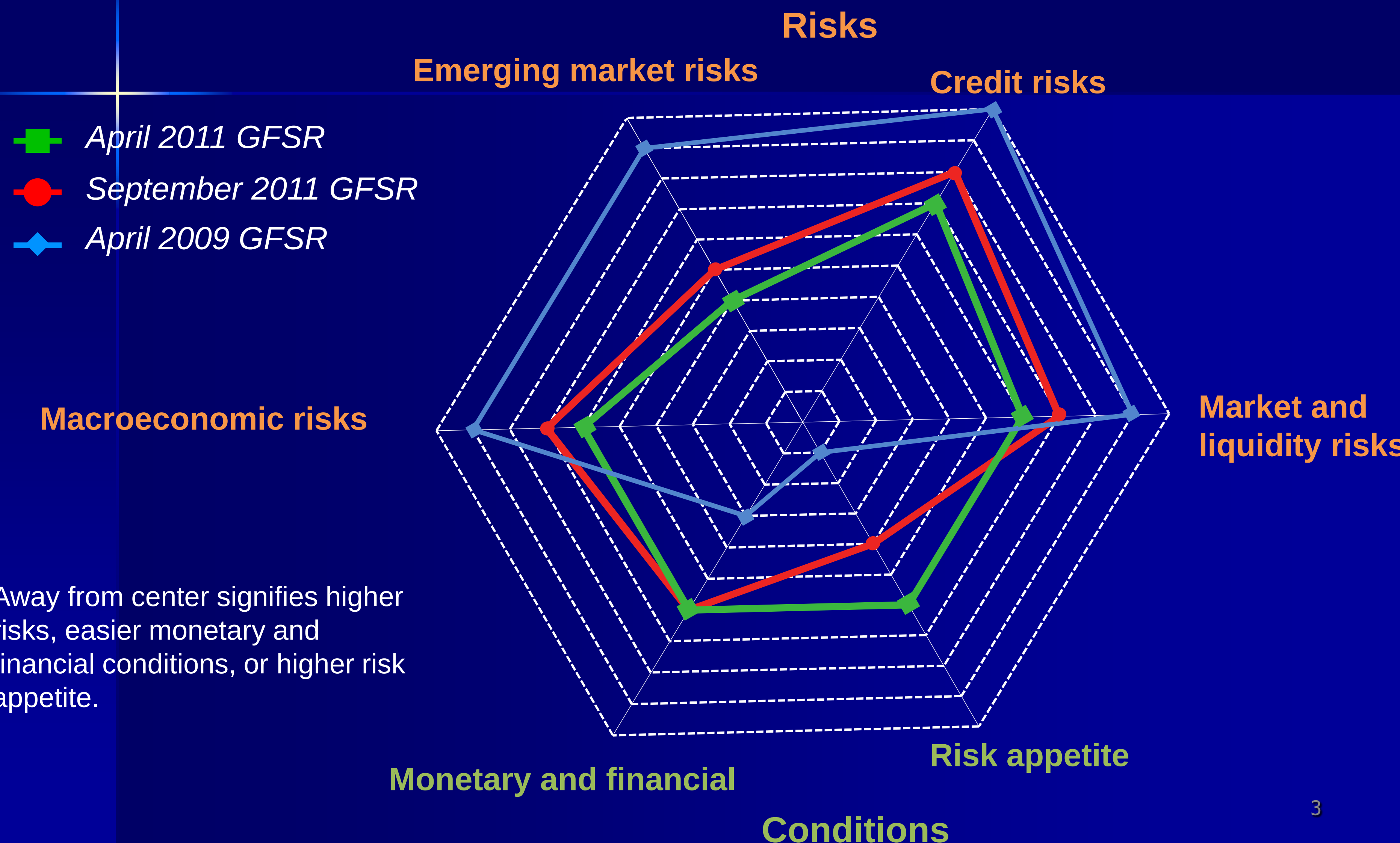
World Trade
(annualized %change of 3m ma over previous 3m ma)



Government Bond Spreads
(2y yield spreads over German bunds; bpts)



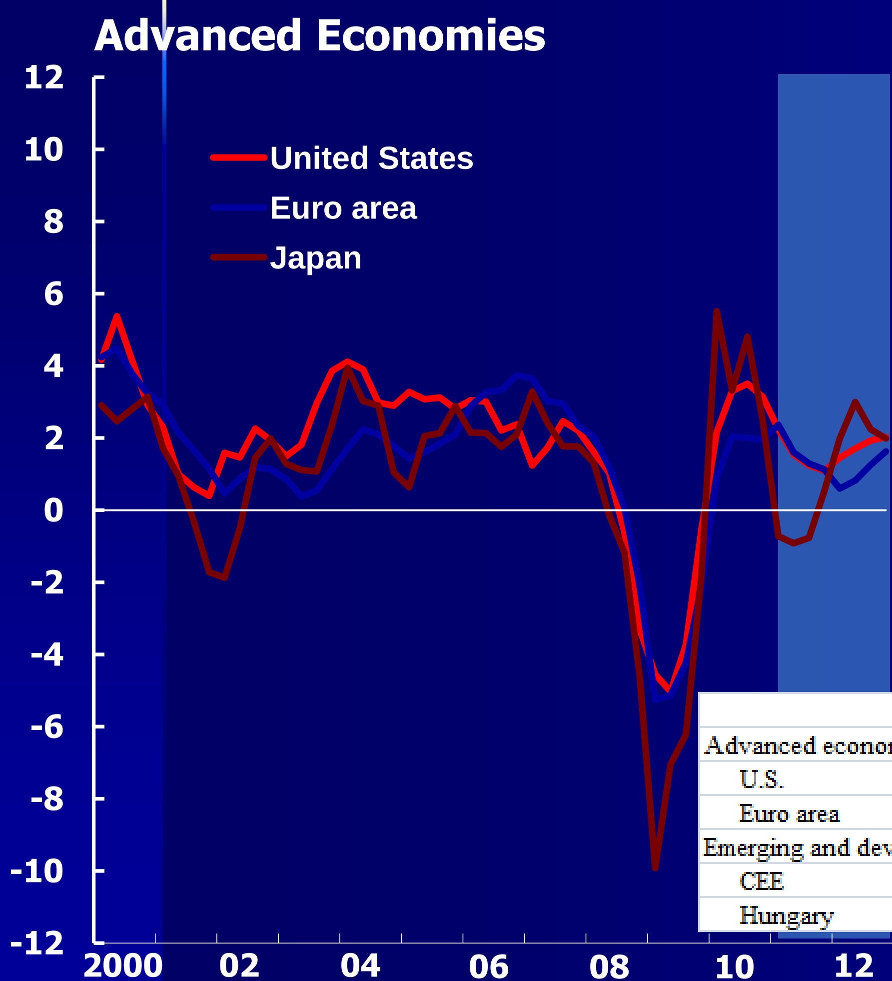
Stability Risks Increased Across all Risk Metrics

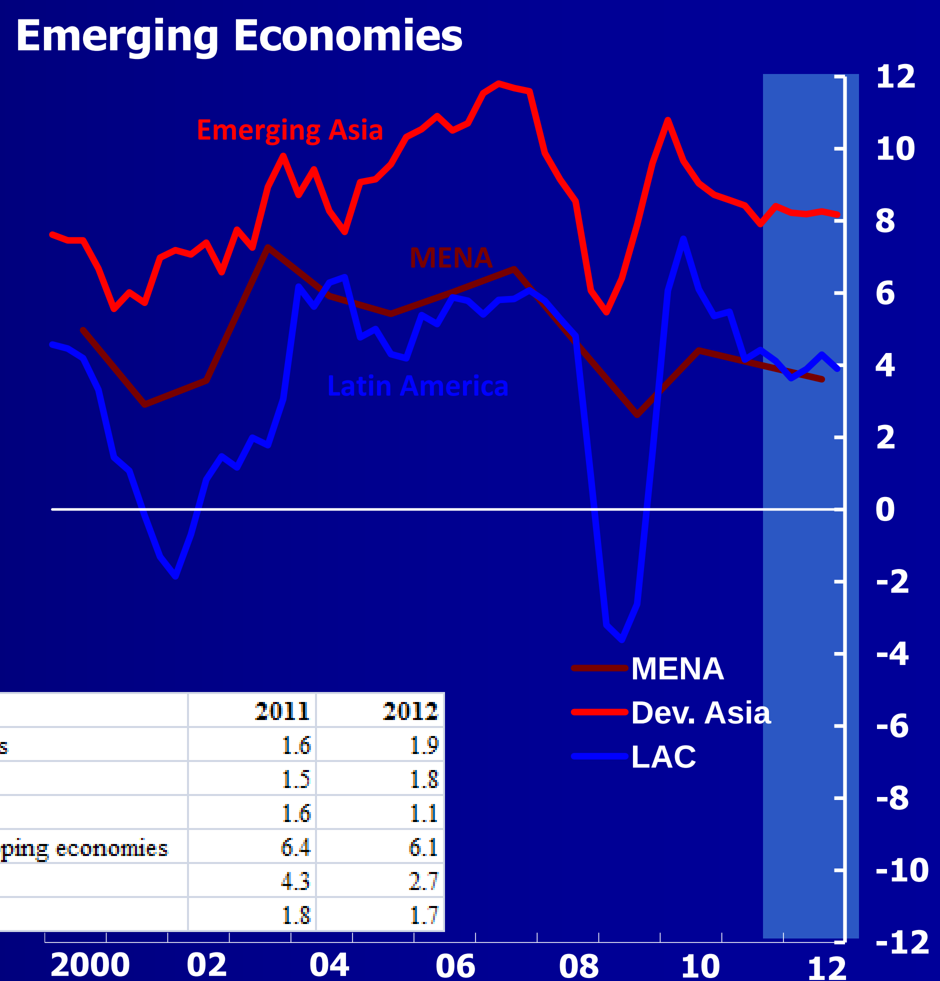


Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

The baseline forecast: more uneven recovery: > 6 % in EM, < 2 % AE = 4 % global growth.

Real GDP Growth
(percent change from a year earlier)



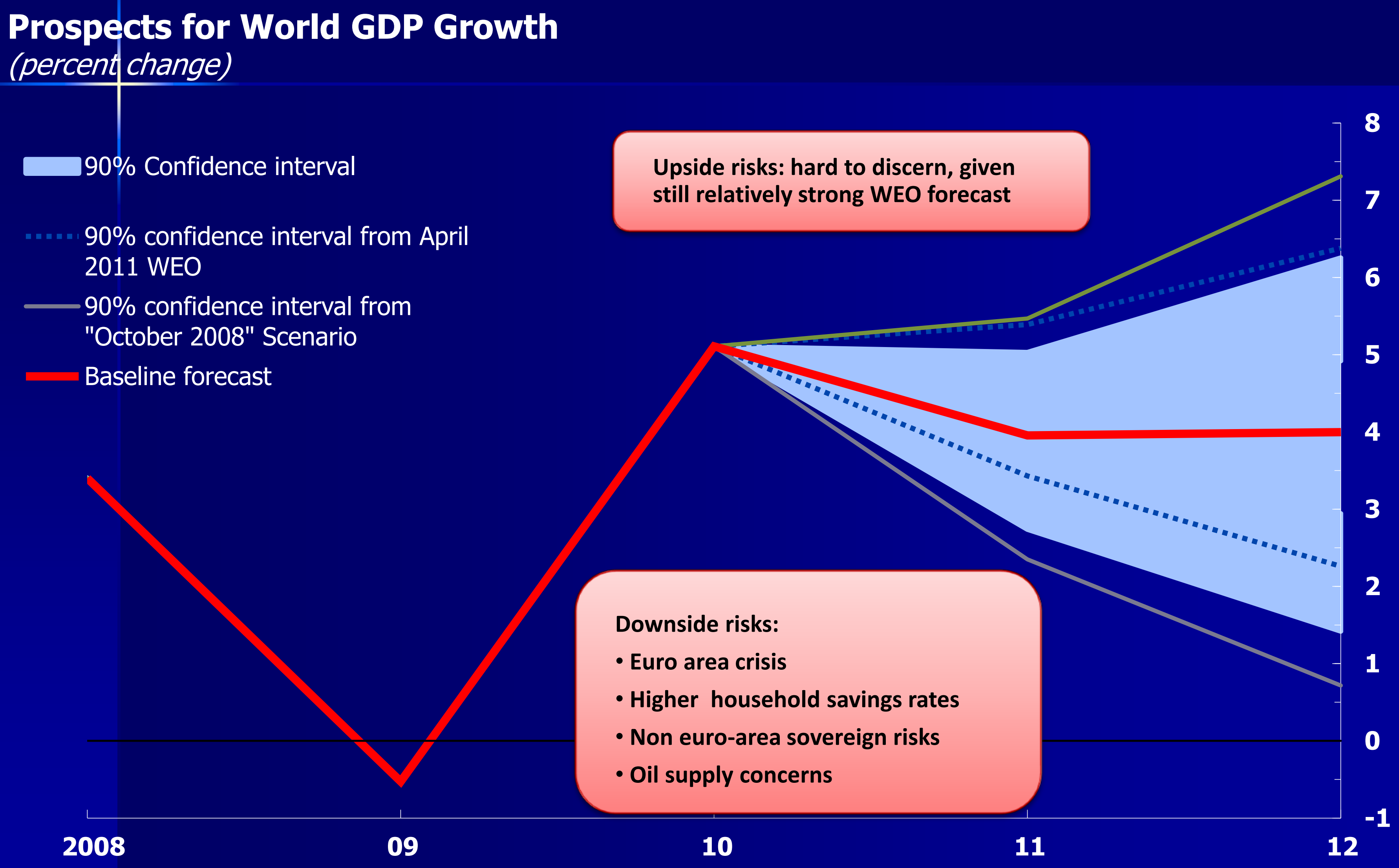


	2011	2012
Advanced economies	1.6	1.9
U.S.	1.5	1.8
Euro area	1.6	1.1
Emerging and developing economies	6.4	6.1
CEE	4.3	2.7
Hungary	1.8	1.7

Baseline: no doomsday

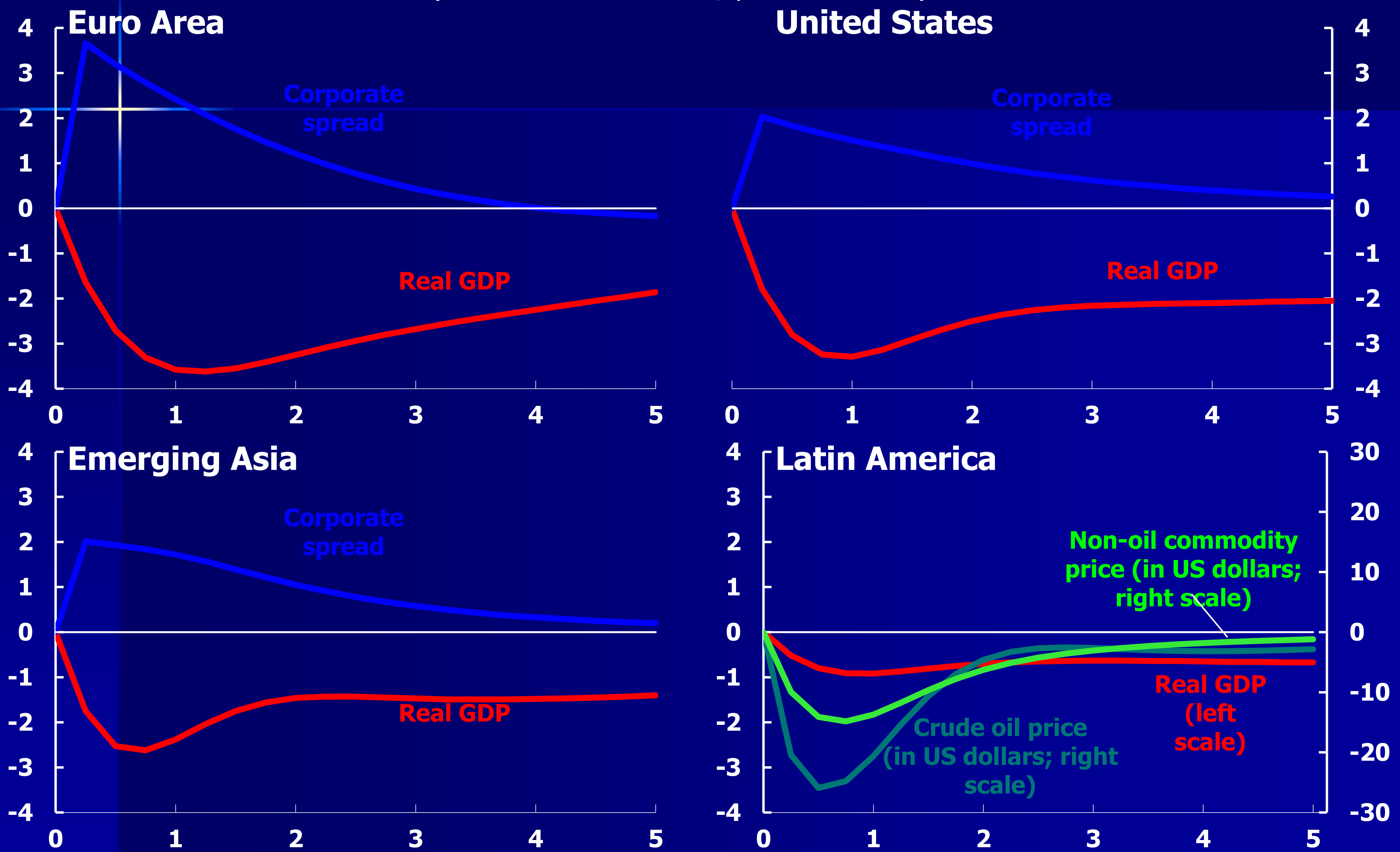
- Key assumption underlying the WEO baseline: financial recovery delayed but not derailed.
-
- 1. Euro area crisis does not run out of control.
- 2. Global financial volatility does not escalate.
- 3. No major tightening of bank lending conditions.

Risks: Increased and on the Downside
Risk (global growth < 2 percent)=10%!



Downside scenarios point to potentially large output losses.

Downside Scenario
(Deviation from control; years on x-axis)



Policy choices

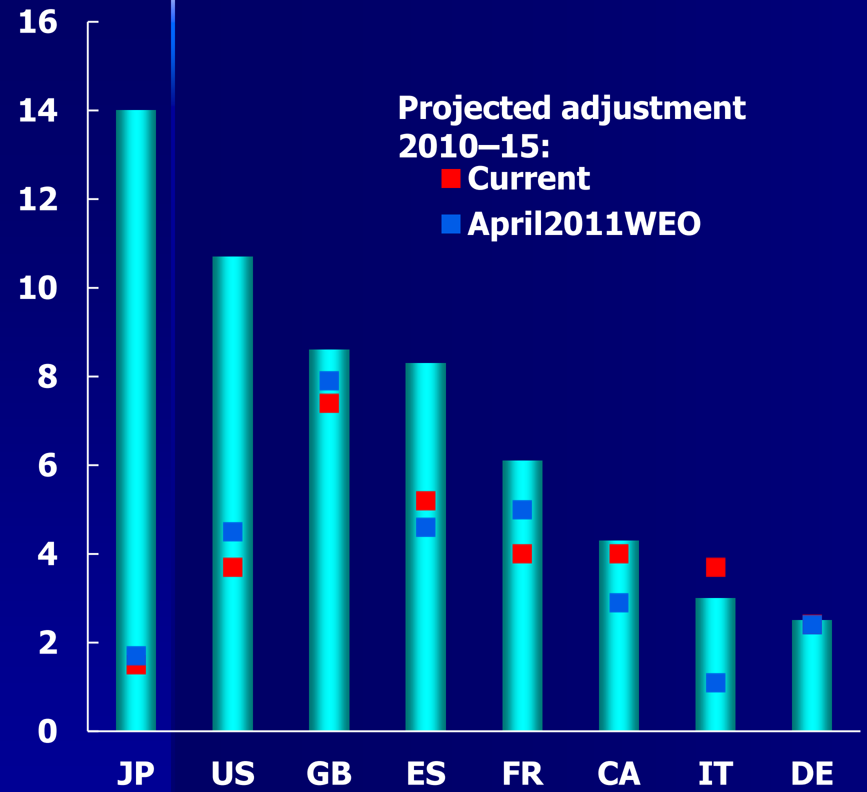
Advanced economies—most urgent: strengthened euro area crisis management framework; raise capital buffers (incl. from EFSF); credible medium-term fiscal consolidation that helps avoid overly strong short-term adjustment; supportive monetary policy.

Emerging and developing economies: structural reforms and currency appreciation in key surplus economies; policies to avert build-up of financial vulnerabilities; social safety nets.

Other (regulatory, IMS, etc): Financial regulation, new macroprudential tools, enhance IMF surveillance and strengthen global financial safety net; reform global financial system; trade.

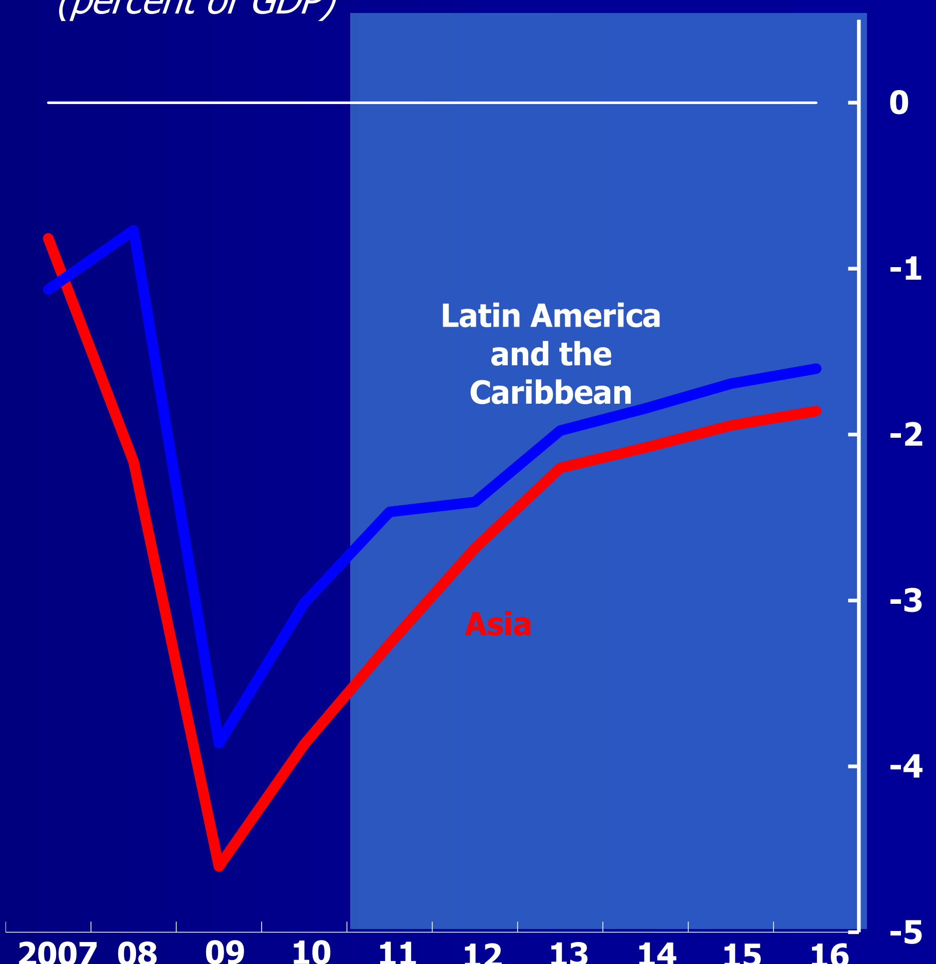
Some AE have made good fiscal progress (but not yet US, JP). EM are in a better position.

Required Adjustment[1,2]
(percent of GDP)



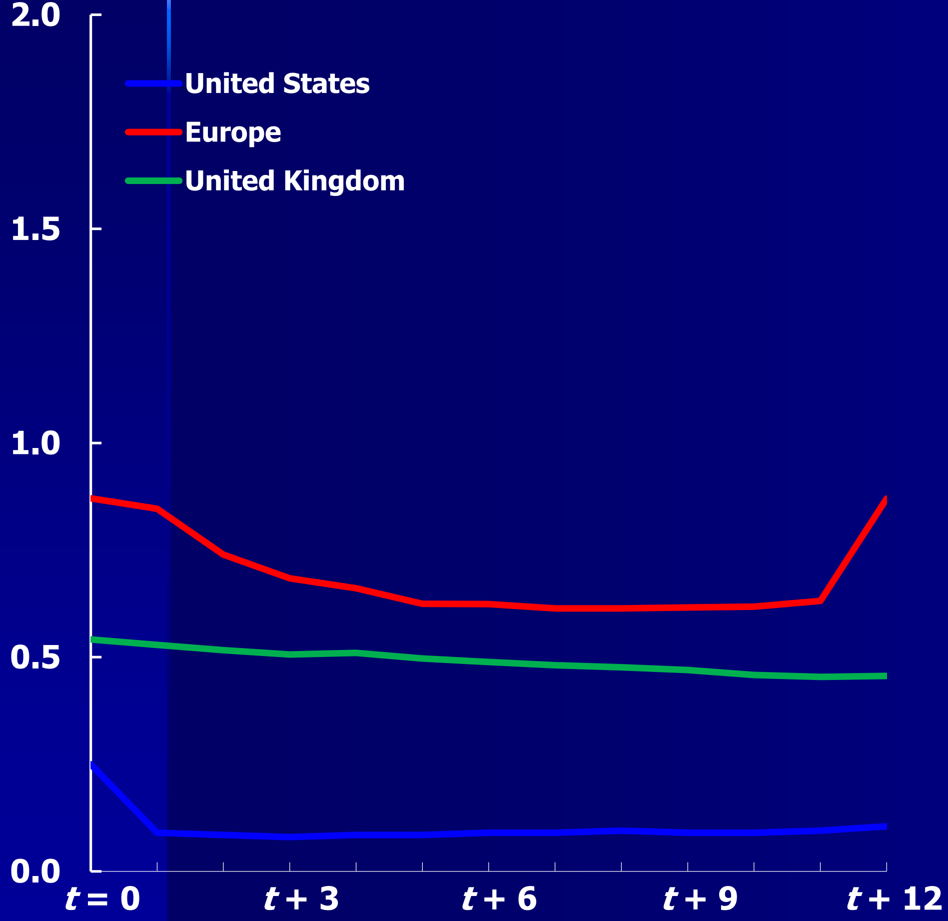
Sources: IMF, *Fiscal Monitor*, and IMF staff calculations.
[1] CA: Canada, FR: France, DE: Germany, IT: Italy, JP: Japan, ES: Spain, GB: United Kingdom, US: United States.
[2] Cyclically adjusted primary balance adjustment needed to the debt ratio to 60 percent in 2030, except for Japan.

Fiscal Balance
(percent of GDP)

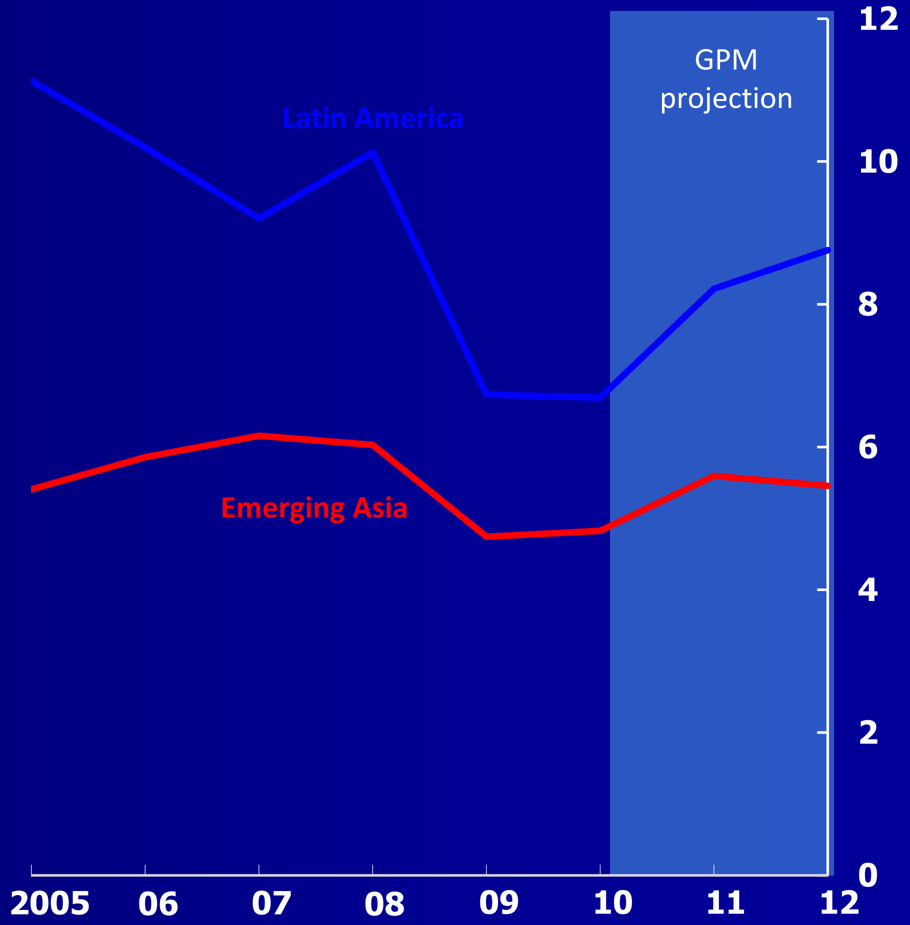


AE monetary policy must stay very accommodative. EM&DC requirements vary: some can pause tightening.

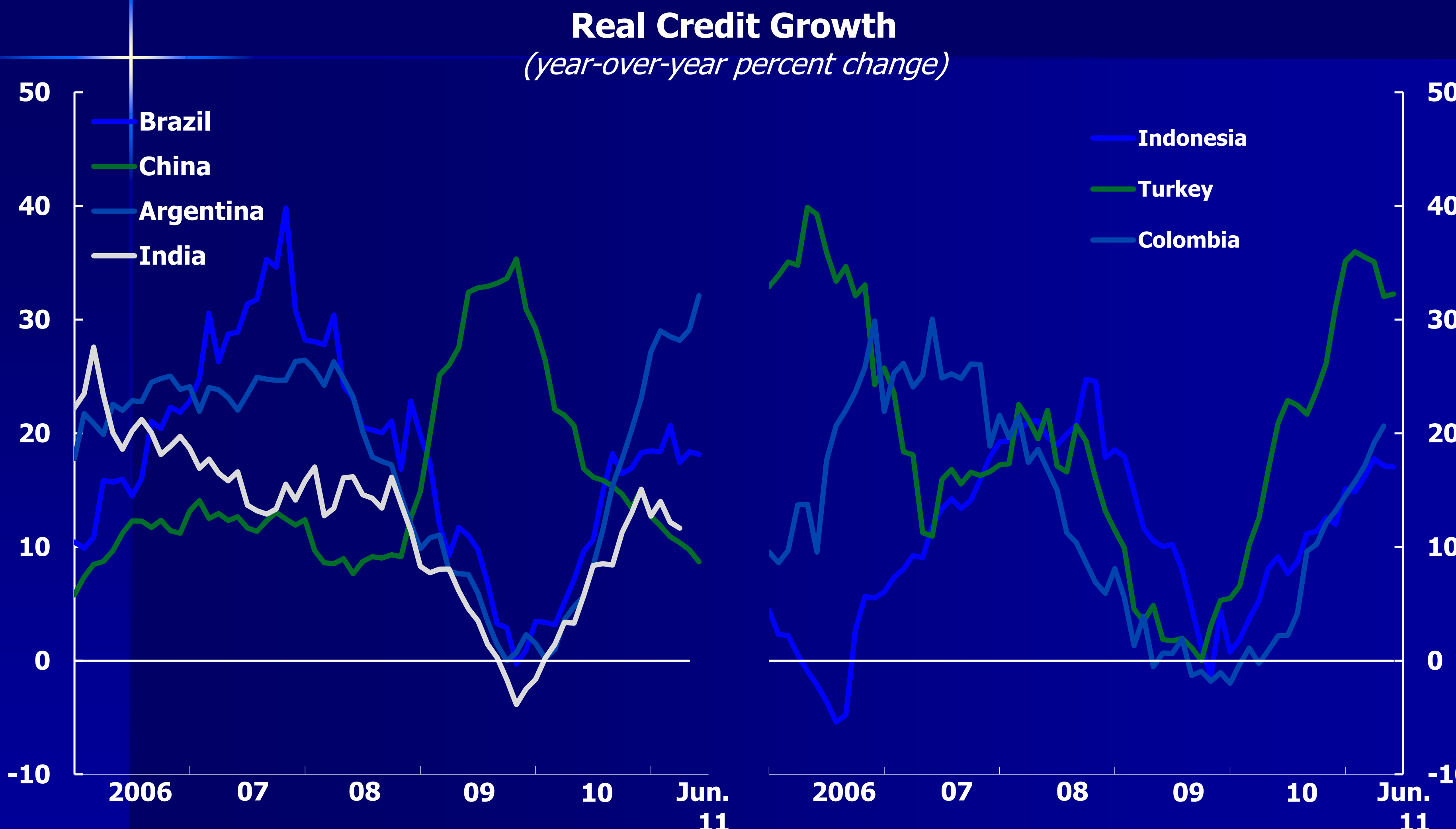
Policy Rate Expectations
(percent; months on x-axis; dashed lines are from the April 2011 World Economic Outlook.)



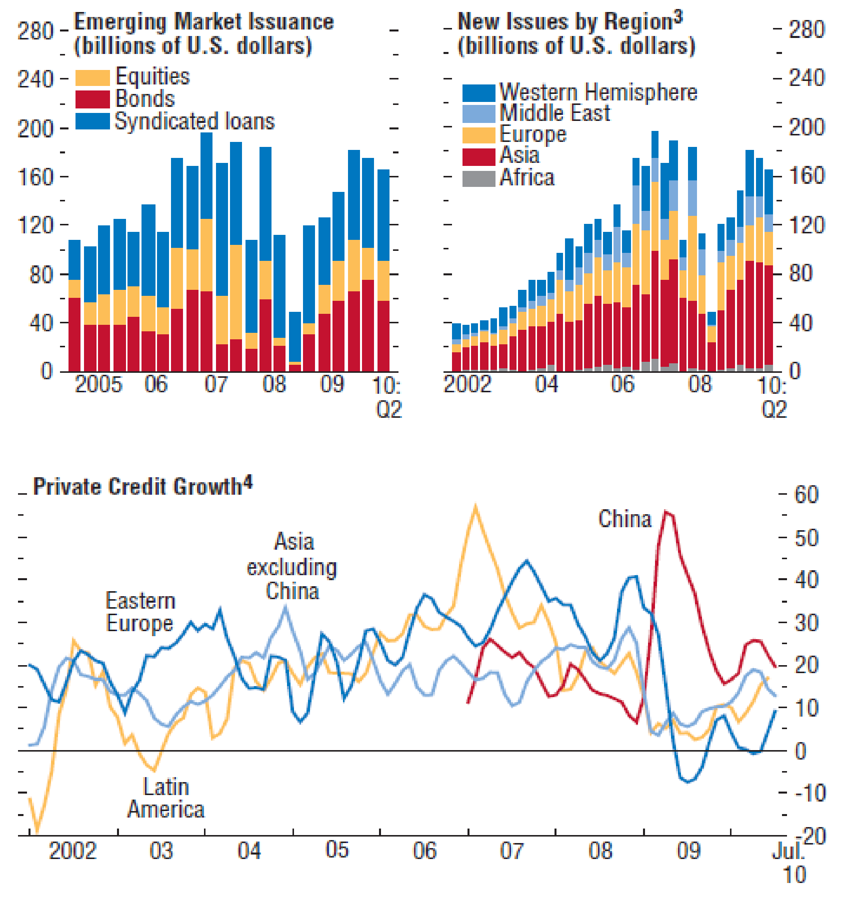
Policy Rates
(percent)



Real credit growth is still high in a number of EM—need to continue to watch for prudential risks.



Uneven within EM: Europe Lagging



Sources: Bloomberg Financial Markets; Capital Data; IMF, *International Financial Statistics*; and IMF staff calculations.

EM Europe Lagging

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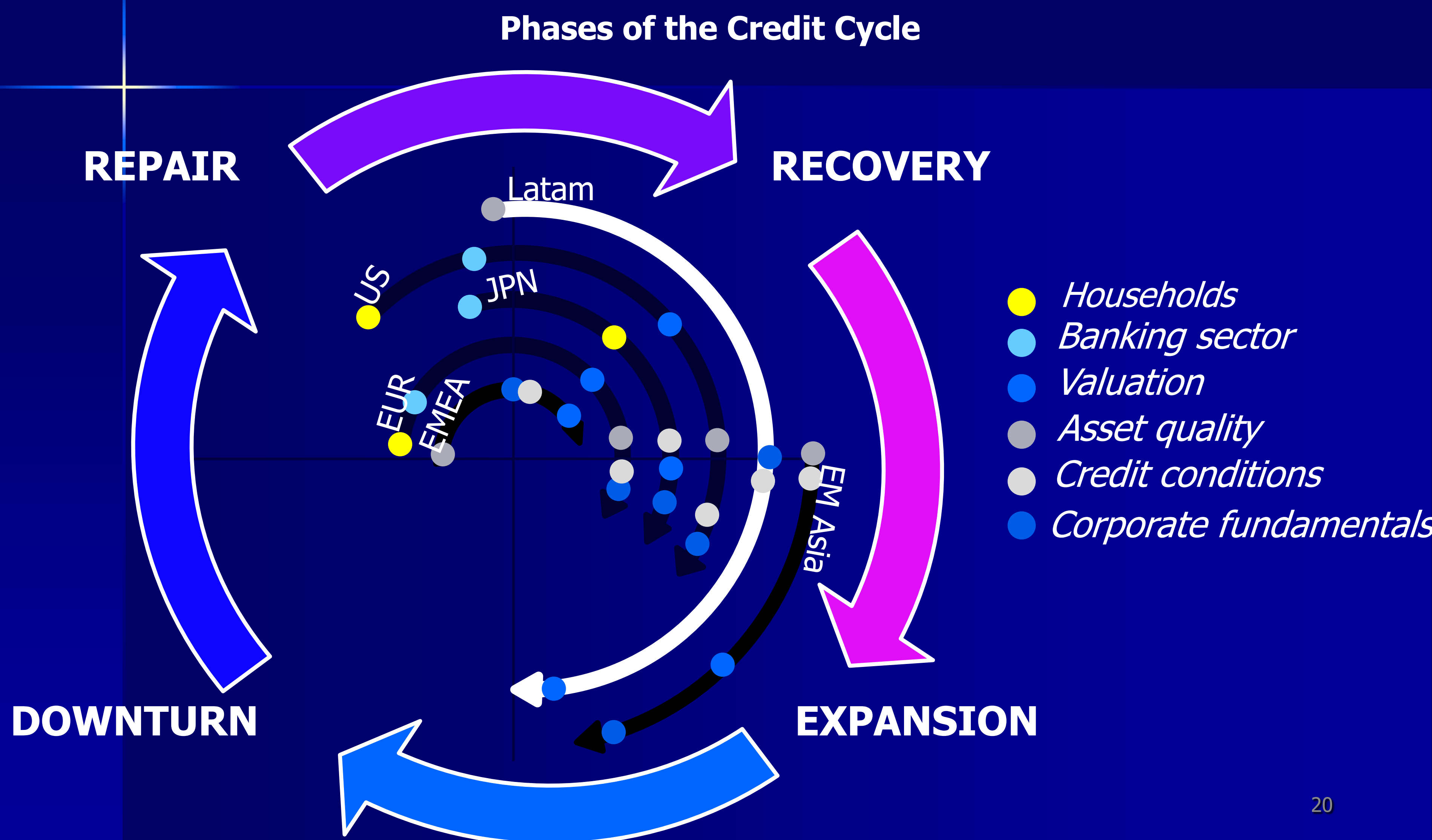
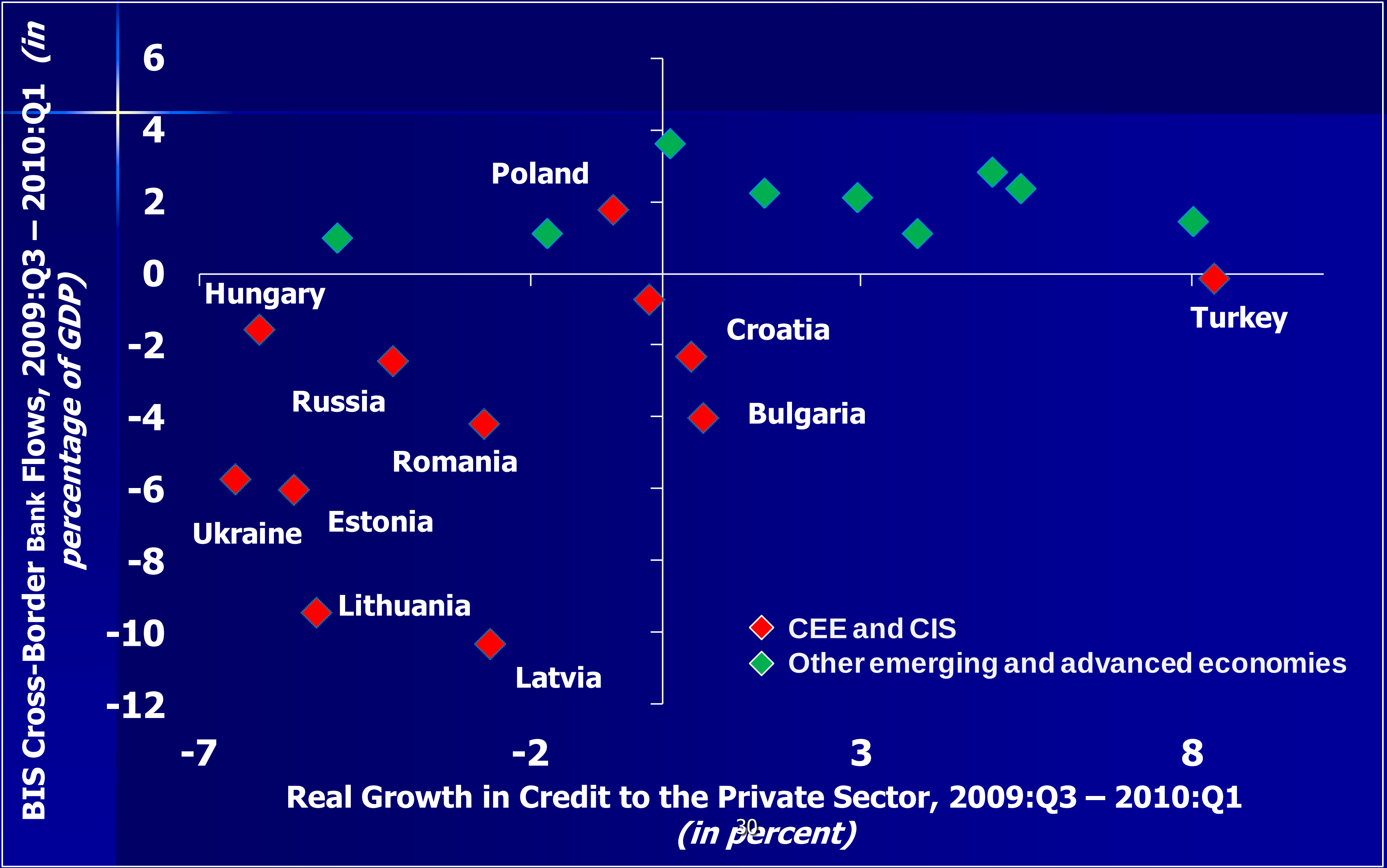
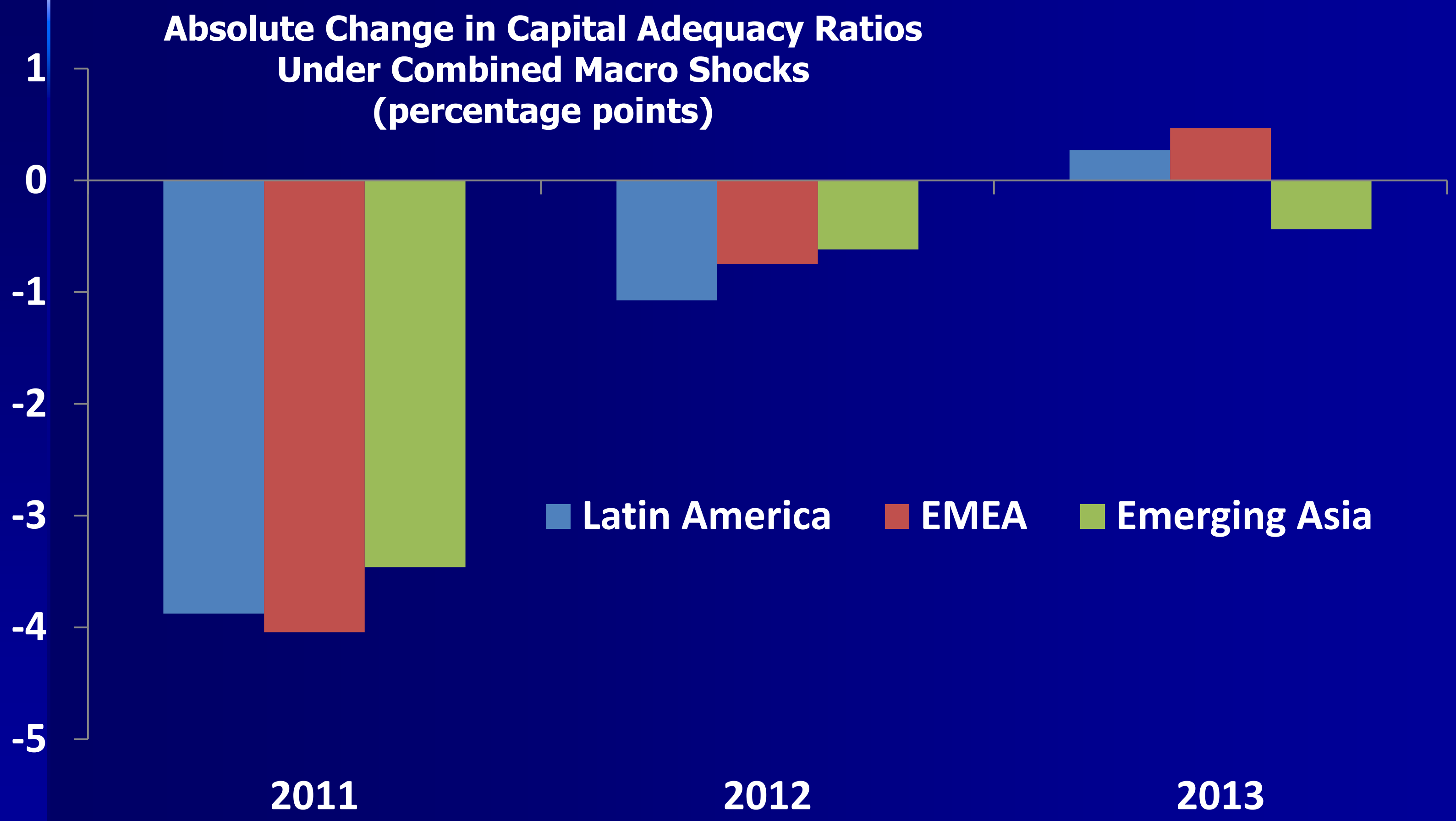
Emerging economies are further along in the credit cycle, EM Europe Lagging



CEE vulnerable to cross-border bank deleveraging



An external shock would test the resilience of emerging market banks



Advanced Economies avoid *near-term* crisis

Sovereign risks	Balance sheet repair	Public (US, EU, Japan)	medium-term credible fiscal consolidation
		Private (Households, US)	mortgage debt - banks
Banks		Banks (EU)	more capital (private, public, EFSF) funding structures

Complete financial reform agenda

Emerging Economies avoid *future* crisis

Contain buildup of macro-financial vulnerabilities

Enhance macro-financial resilience to cope with external shocks

macro (monetary, fiscal)

macro-prudential and CFM

structural financial reform

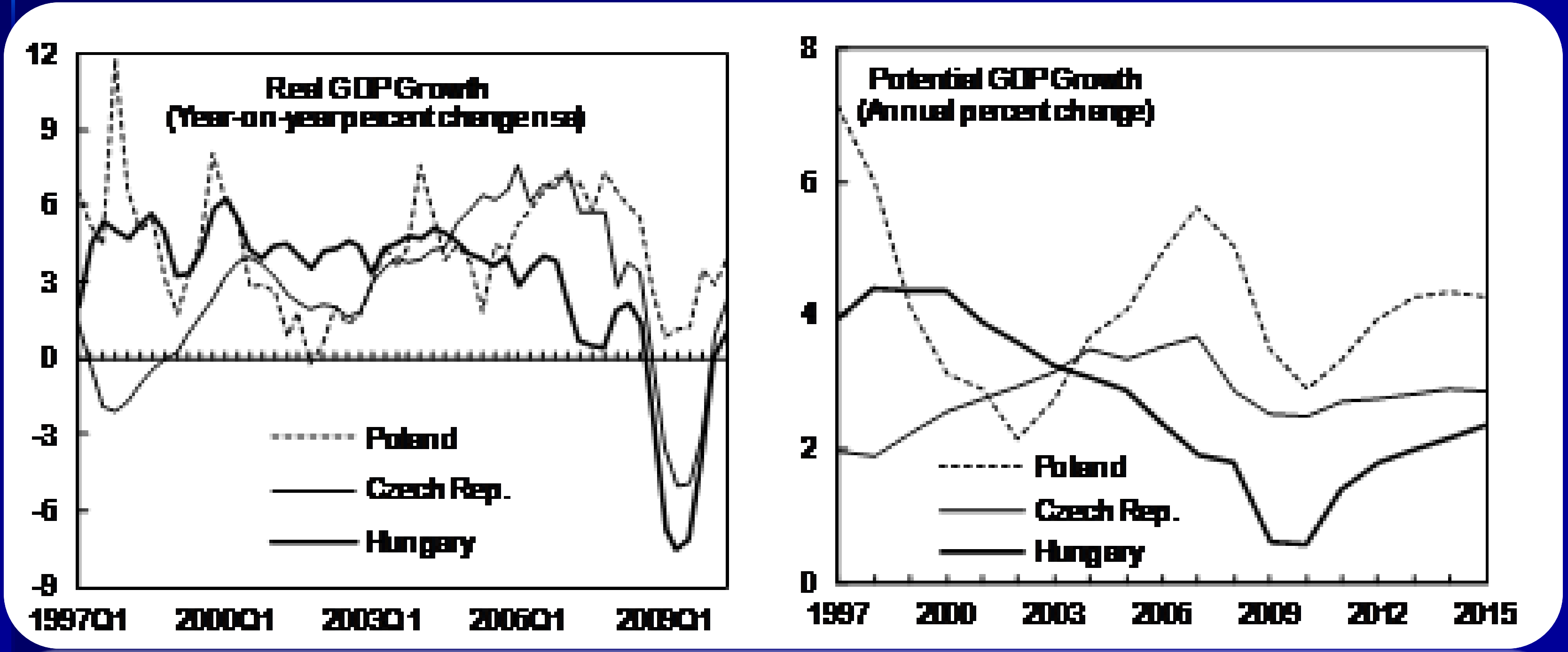
Hungary: Weak Short-Term Outlook

- Growth: weak and below CEE average,
- CA surplus
- Inflation manageable
- Fiscal: good headline, structural mixed
- Financial stability: economy, policies take toll
- Stock vulnerabilities: public and net external debt, FX debt
- Sizeable gross financing needs
- Muddling-through baseline, downside risks

Policies short-term: Stability vs Stimulus

- Fiscal: consolidation course helps stability, need to ensure good structure
  - structural adjustment on spending side-helpful for sustainability and growth
- Monetary: appropriately cautious
- Other: need to shore up confidence, reduce policy unpredictability, take care of investment climate

Long-Term: Modest Growth



Policies Going Forward: Fiscal Prudence and Reforms

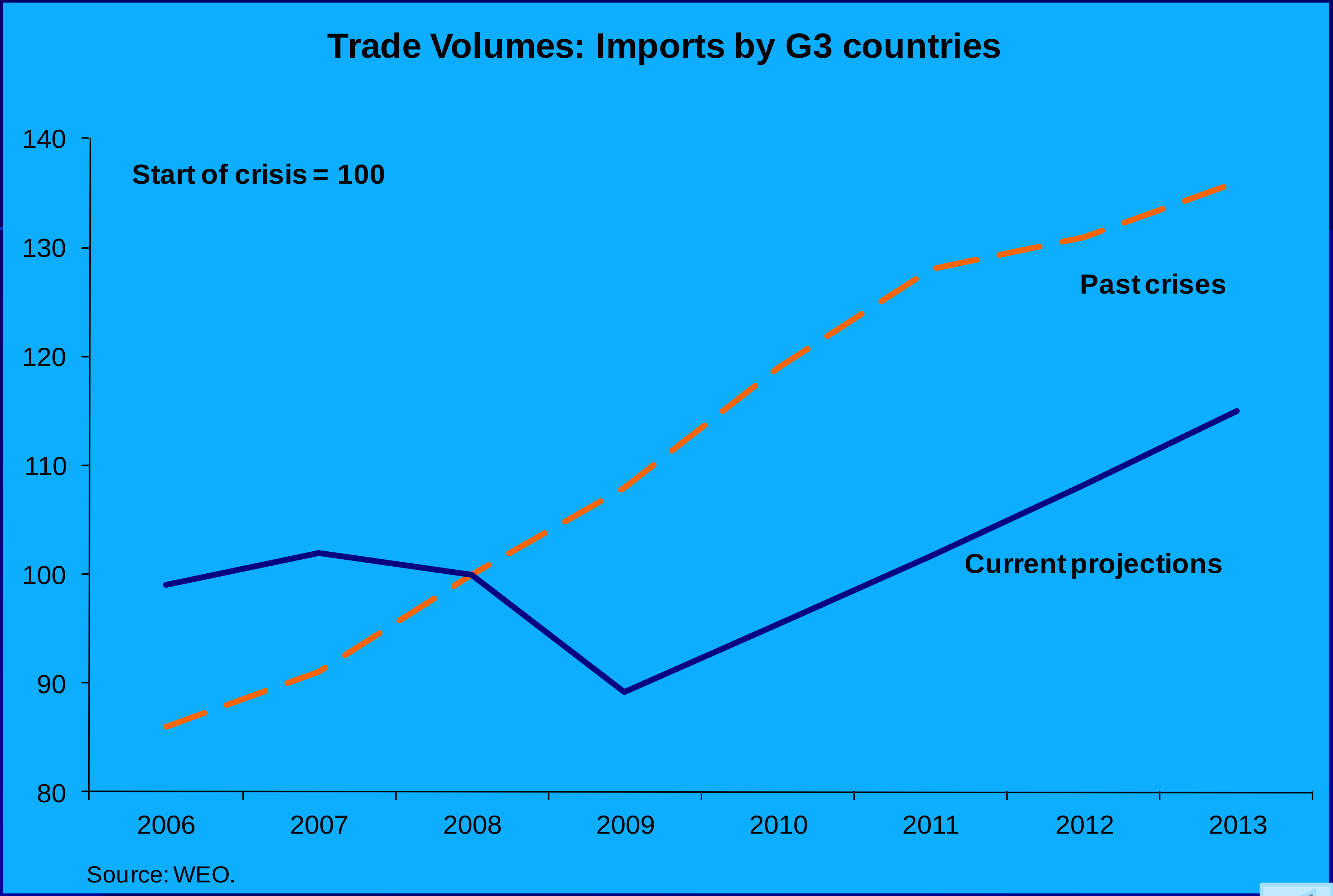
- **Continue fiscal discipline** to:
  - Reduce vulnerability
  - Create room for growth-boosting bold reforms
- Maintain financial stability: institutional quality, prevent vulnerabilities
- Structural reforms key for potential growth, which is relatively low in Hungary
  - No lack of good reform ideas in Hungary

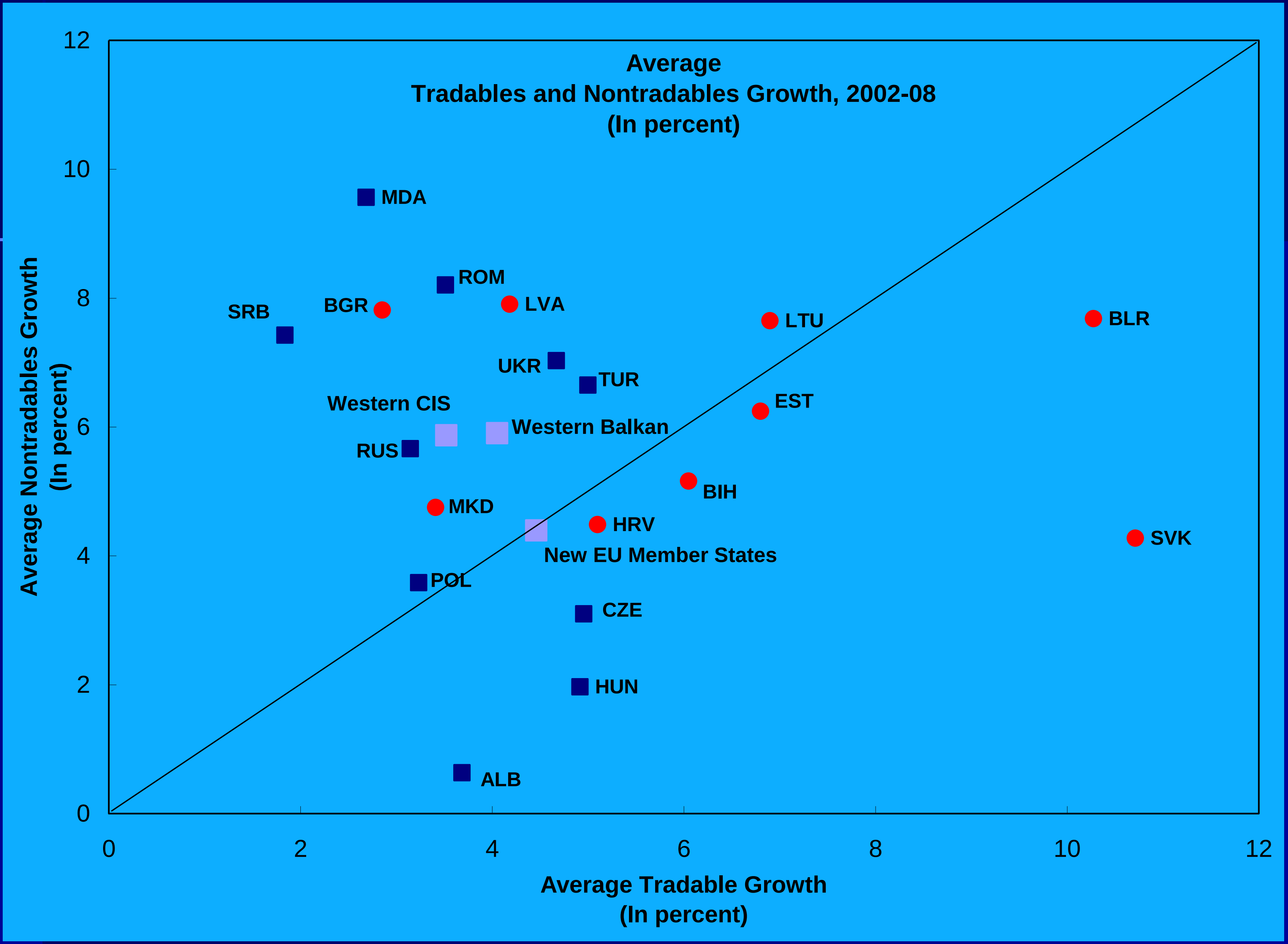
Useful Ideas for Reforms

- Public Administration: better budget and quality of public services, lower administrative burden, improved business climate
    - Local Governments: control over general budget, better quality of services (education, health, utilities)
- Welfare reform: higher labor participation
- Public Transport System (MAV, BKV): reduce subsidy need from the budget (i.e. room for tax cuts and costlier reforms), better quality of services
- Health care, education: can all be good for growth

Financial: Keeping up the Reform Momentum

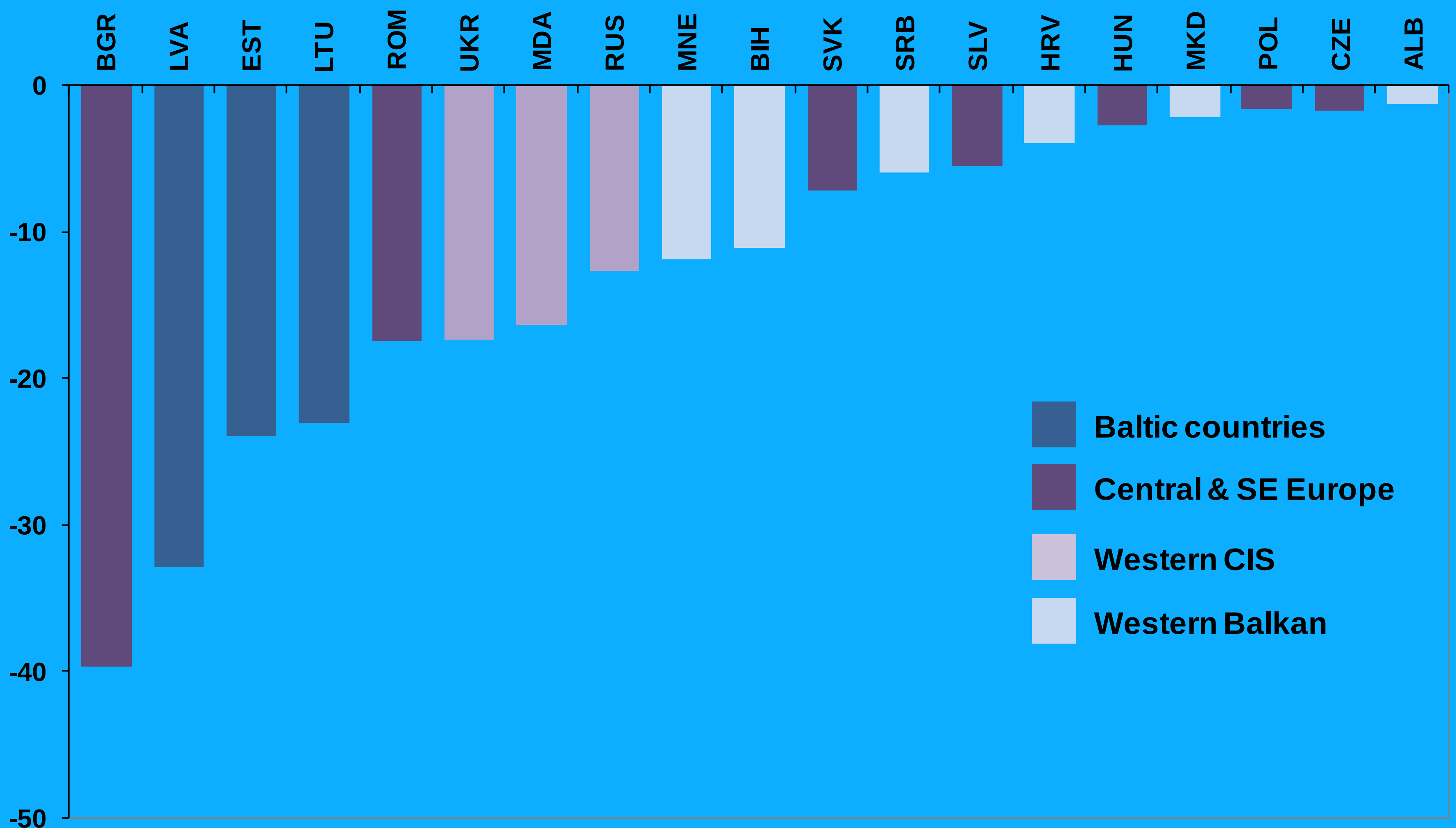
- Strengthening regulatory setup makes it more forward-looking, crisis-resilient:
  - Consistent with European and global process
  - Confidence-boosting
- Continue work on:
  - enhancing bank resolution regime


Trade Volumes: Imports by G3 countries
Start of crisis = 100
Past crises
Current projections
140
130
120
110
100
90
80
2006
2007
2008
2009
2010
2011
2012
2013
Source: WEO.


Average
Tradables and Nontradables Growth, 2002-08
(In percent)
Average Nontradables Growth
(In percent)
Average Tradable Growth
(In percent)
0
2
4
6
8
10
12
MDA
ROM
SRB
BGR
LVA
LTU
BLR
UKR
TUR
Western CIS
EST
Western Balkan
RUS
BIH
MKD
HRV
SVK
New EU Member States
POL
CZE
HUN
ALB

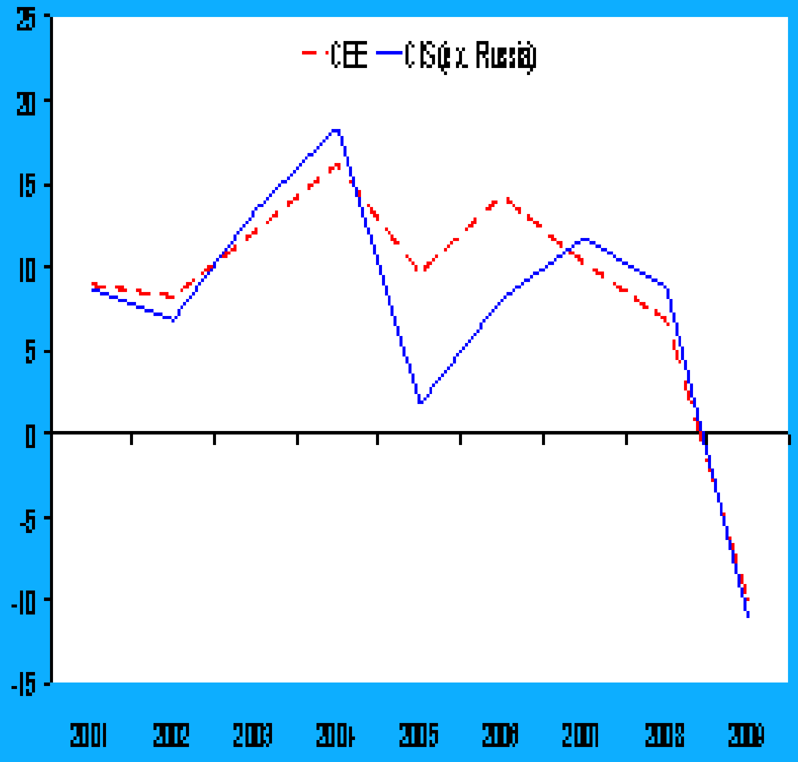
Decline of Capital Inflows

(2007-2009, percent of GDP)



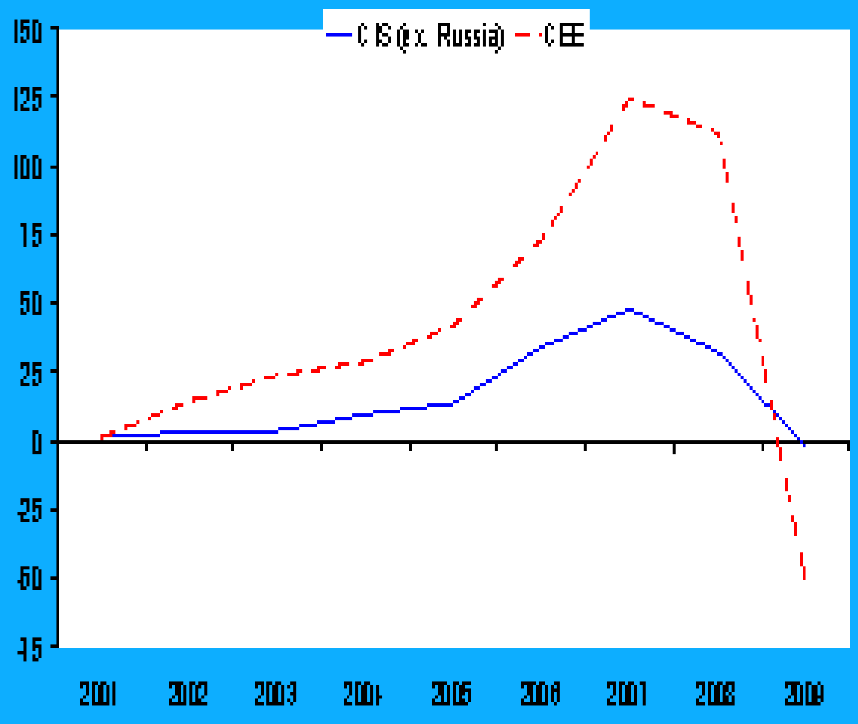
Crisis Backgrounder: Emerging Europe Hard Hit

Volume of exports (annual percentage change)

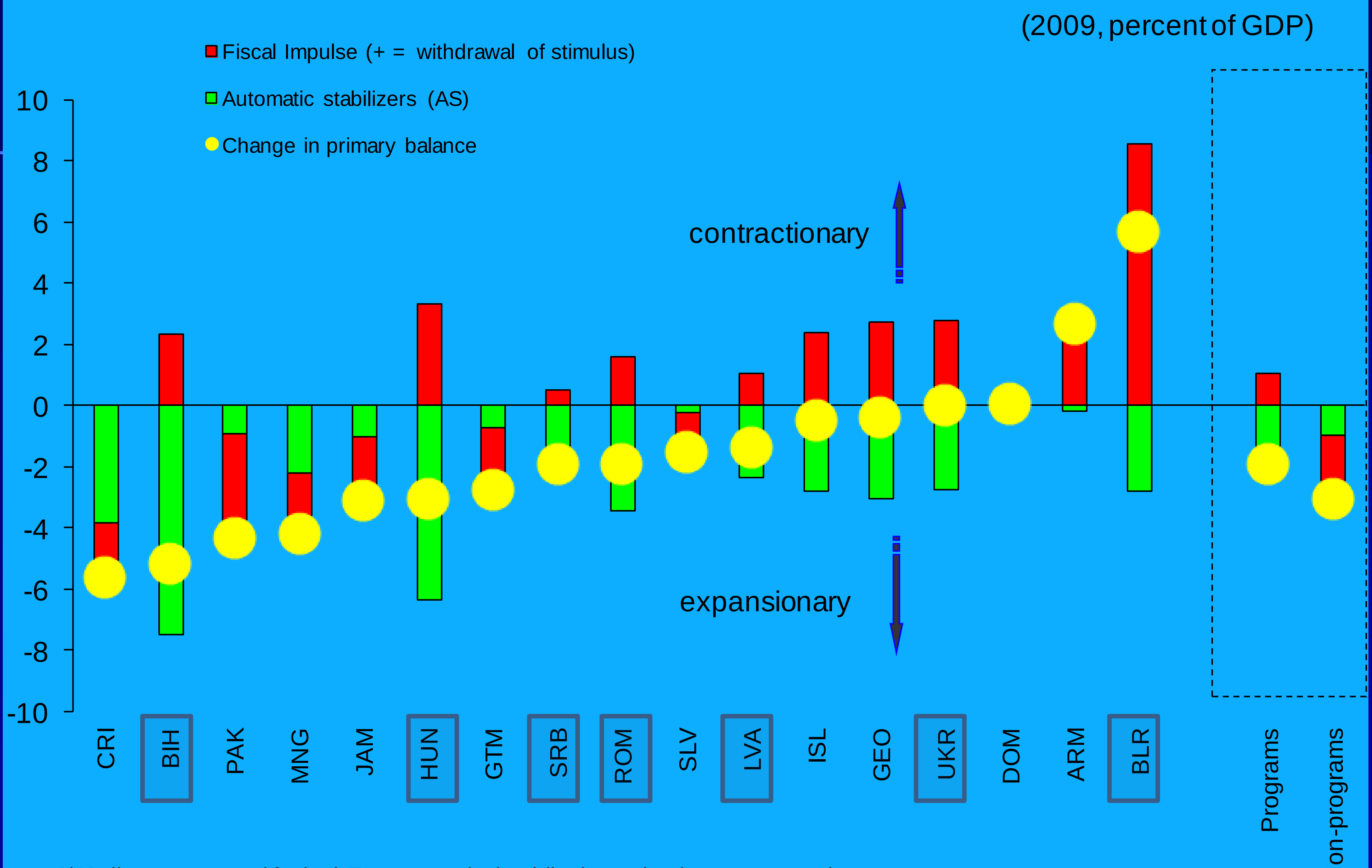


Source: WEO.

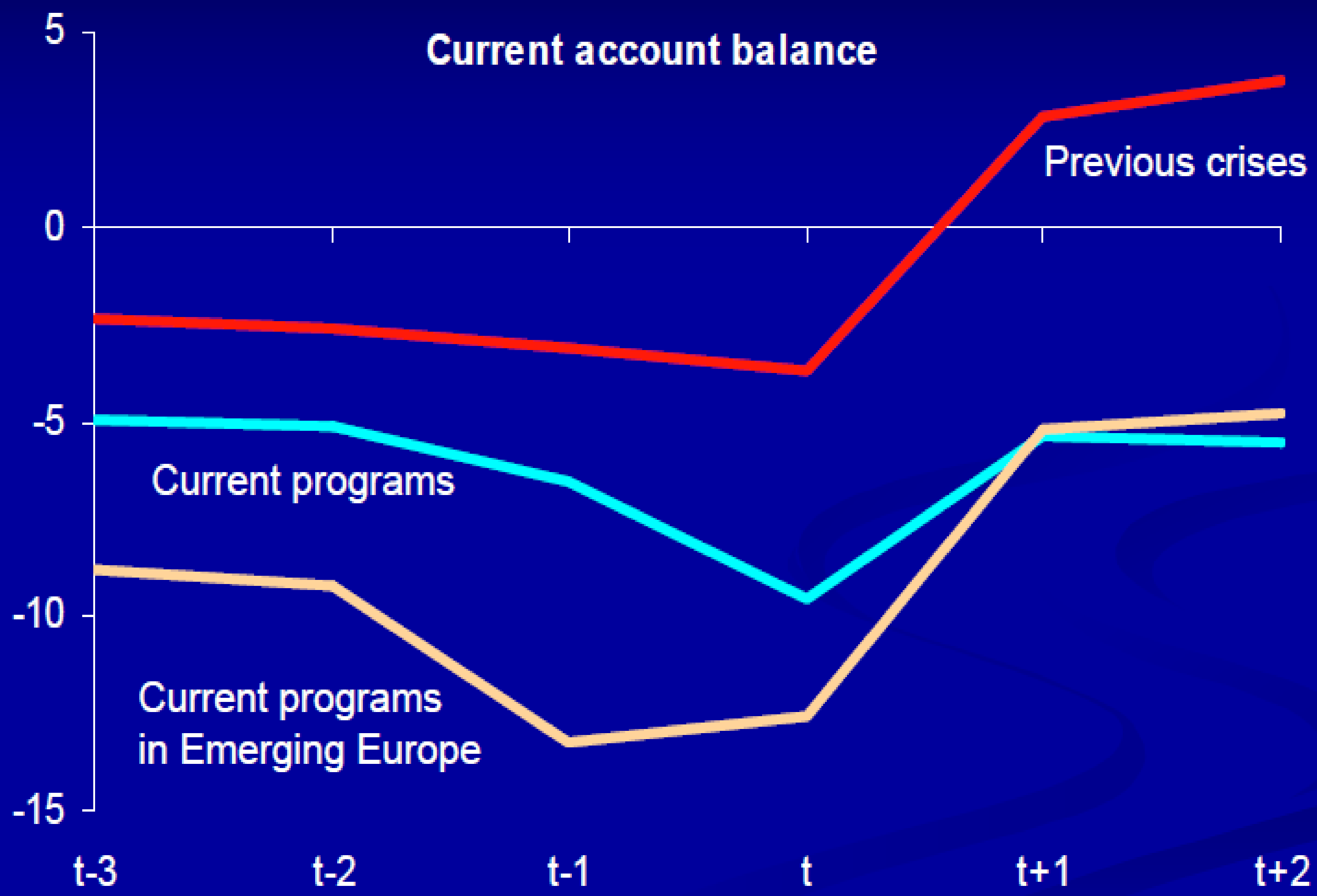
Other investments, liabilities (bn USD)

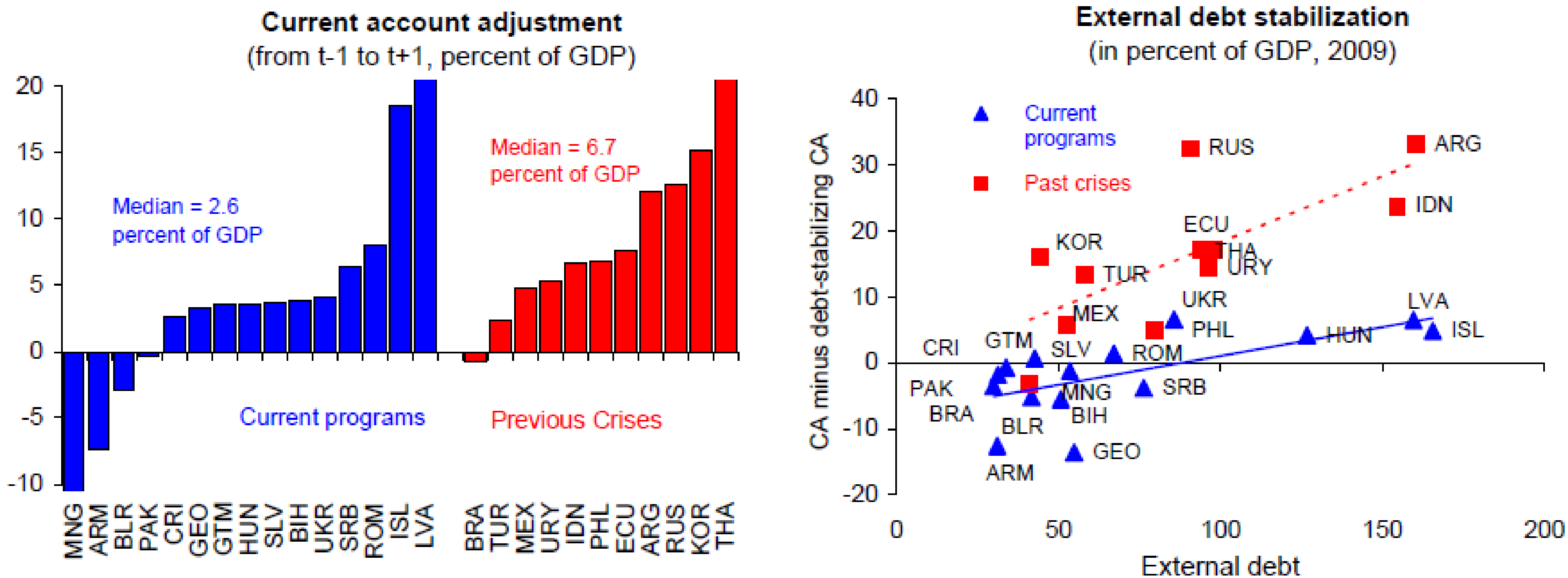


Source: WEO.

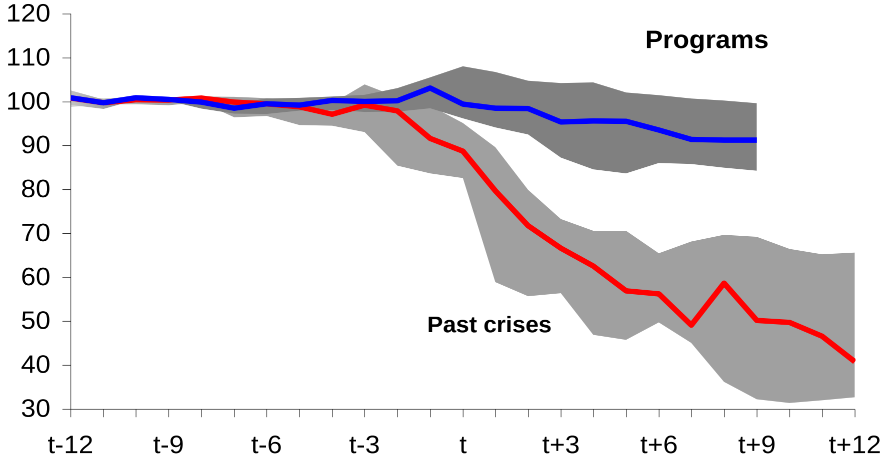


1/ Medians are reported for both European and other (all other regions) program countries.


Current account balance
5
0
-5
-10
-15
Previous crises
Current programs
Current programs
in Emerging Europe
t-3
t-2
t-1
t
t+1
t+2

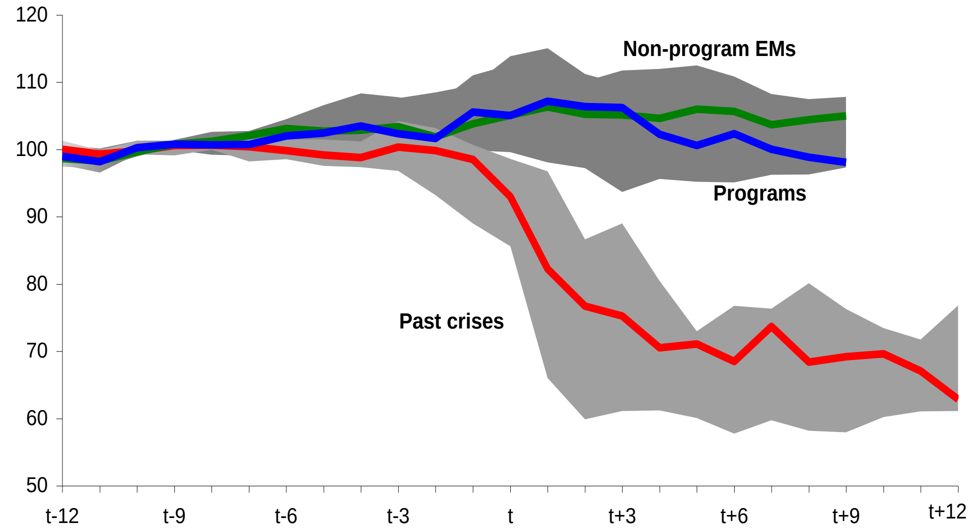

Current account adjustment
(from t-1 to t+1, percent of GDP)
Median = 2.6 percent of GDP
Median = 6.7 percent of GDP
Current programs
Previous Crises
MNG ARM BLR PAK CRI GEO GTM HUN SLV BIH UKR SRB ROM ISL LVA
BRA TUR MEX URY IDN PHL ECU ARG RUS KOR THA
External debt stabilization
(in percent of GDP, 2009)
Current programs
Past crises
CA minus debt-stabilizing CA
External debt
RUS
ARG
IDN
ECU
THA
URY
KOR
TUR
MEX
UKR
PHL
LVA
ISL
HUN
ROM
SLV
GTM
CRI
PAK
BRA
BLR
MNG
BIH
SRB
GEO
ARM

Nominal effective exchange rates
Median and interquartile ranges, average of t-12 to t-7 = 100, monthly 1/

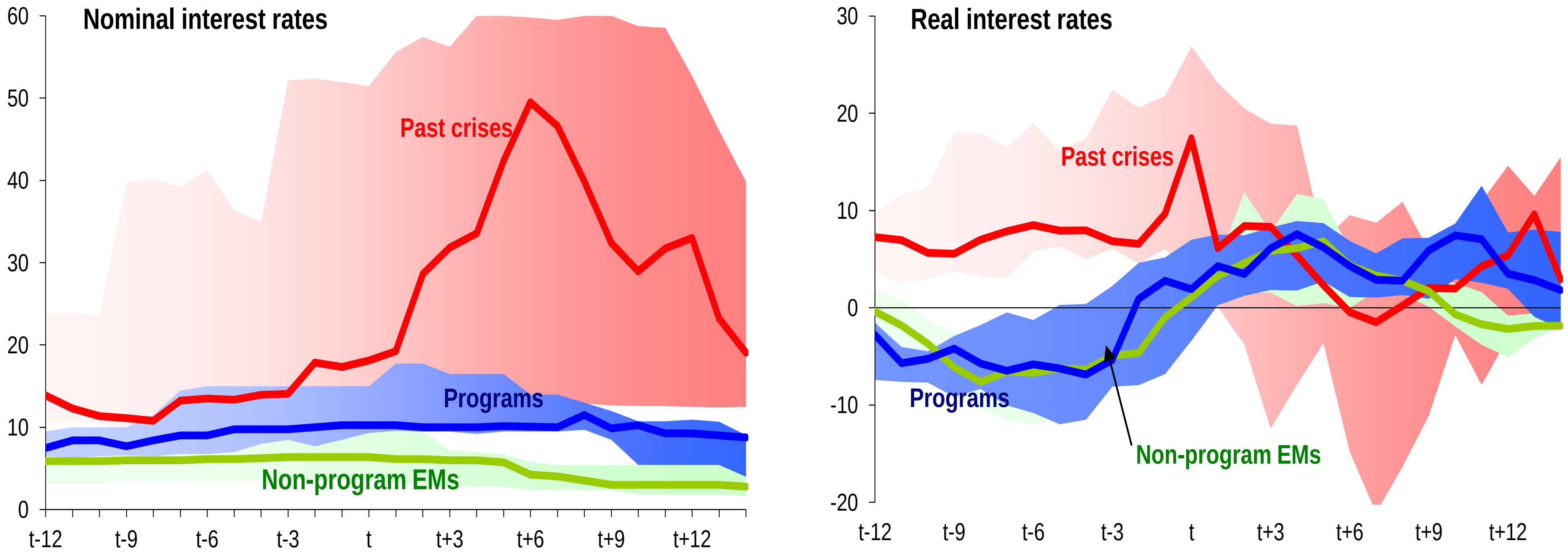


Source: IMF, International Finance Statistics and Fund staff estimates.
1/ "t" represents Oct 2008 for current programs, and beginning of crisis for past crises.

Real effective exchange rates
Median and interquartile ranges, average of t-12 to t-7 = 100, monthly 1/

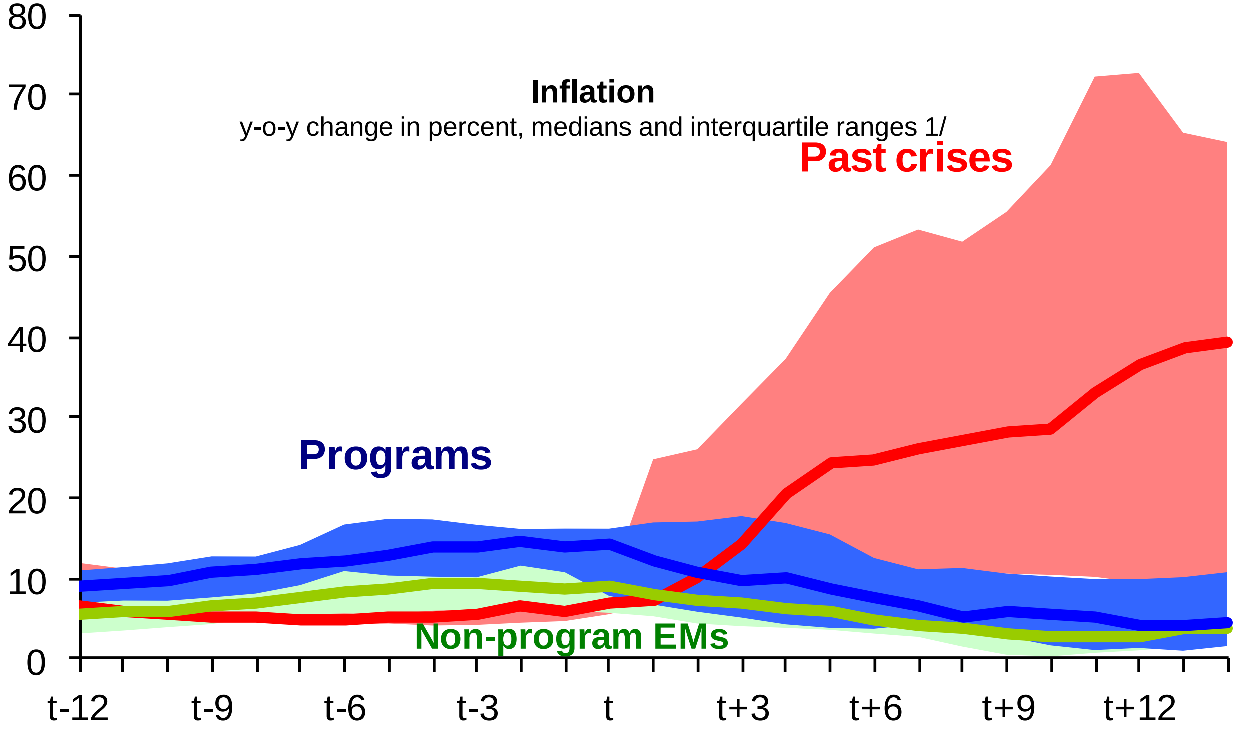


Source: IMF, Information Notice System and staff estimates.
1/ "t" represents Oct 2008 for current programs, and the beginning of the crisis for past crises.



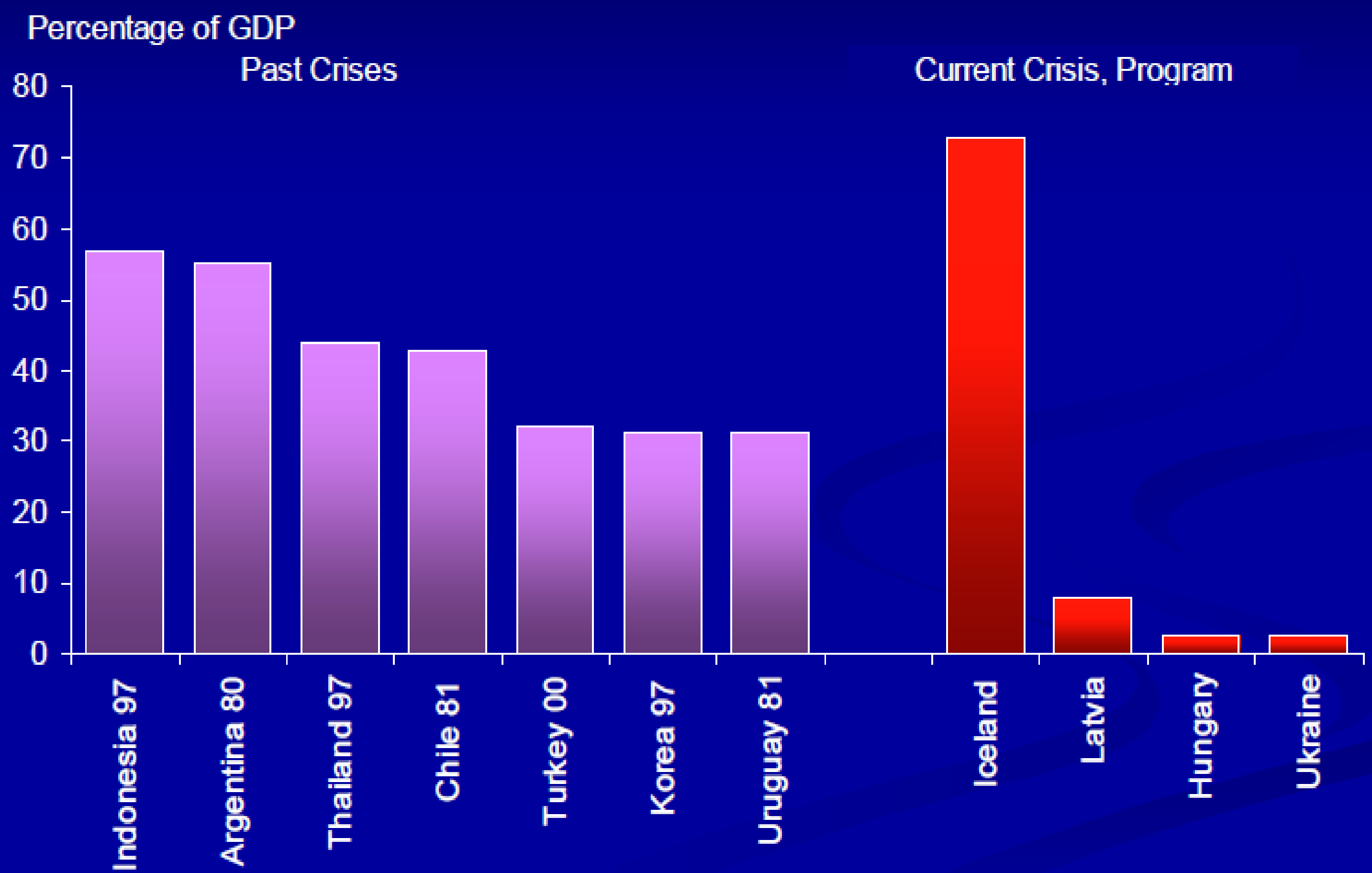
Source: IMF, International Finance Statistics and Fund staff estimates.

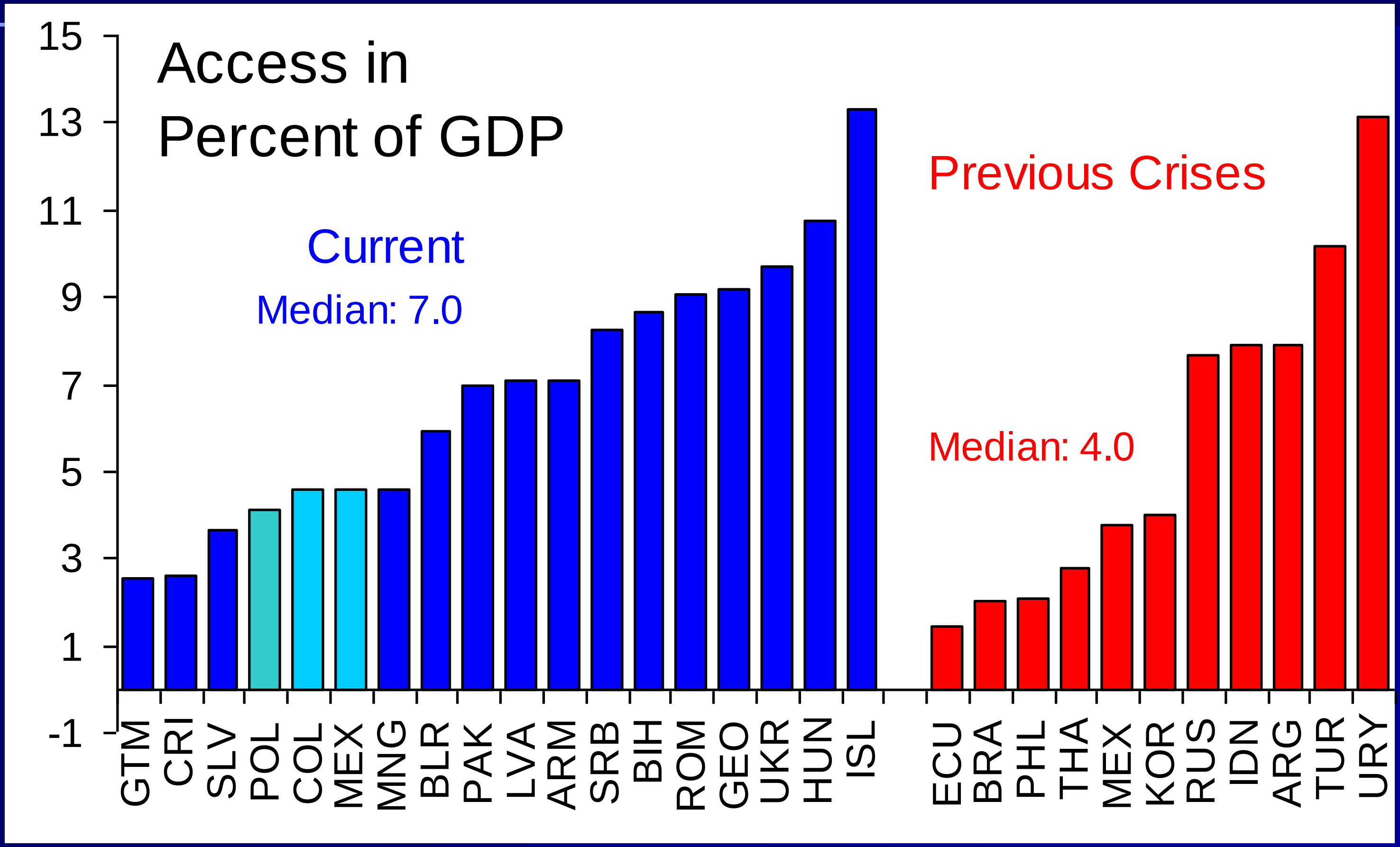
1/ "t" represents Oct 2008 for current programs, and the beginning of the crisis for past crises. EMs include Argentina, Brazil, Chile, China, Croatia, Czech Republic, Ecuador, India,

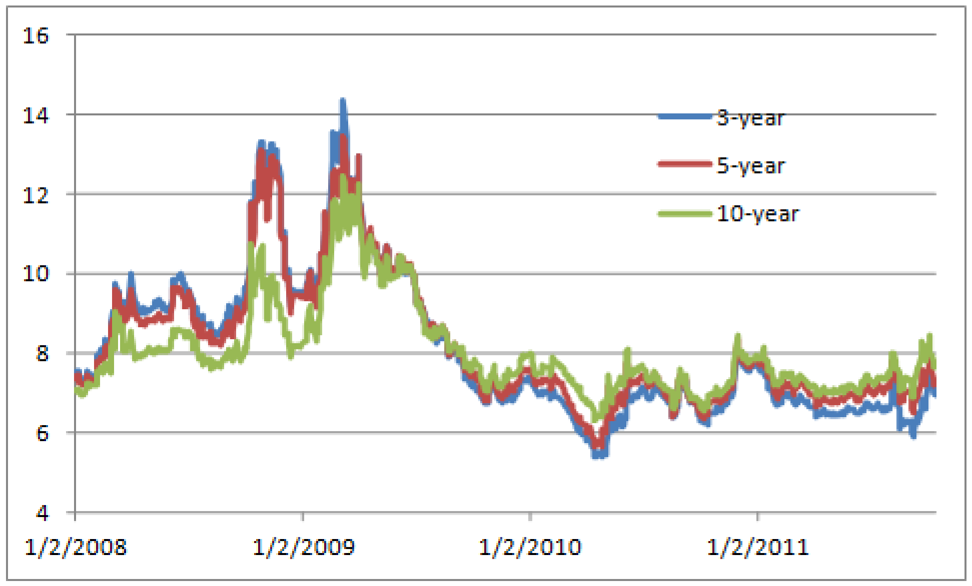


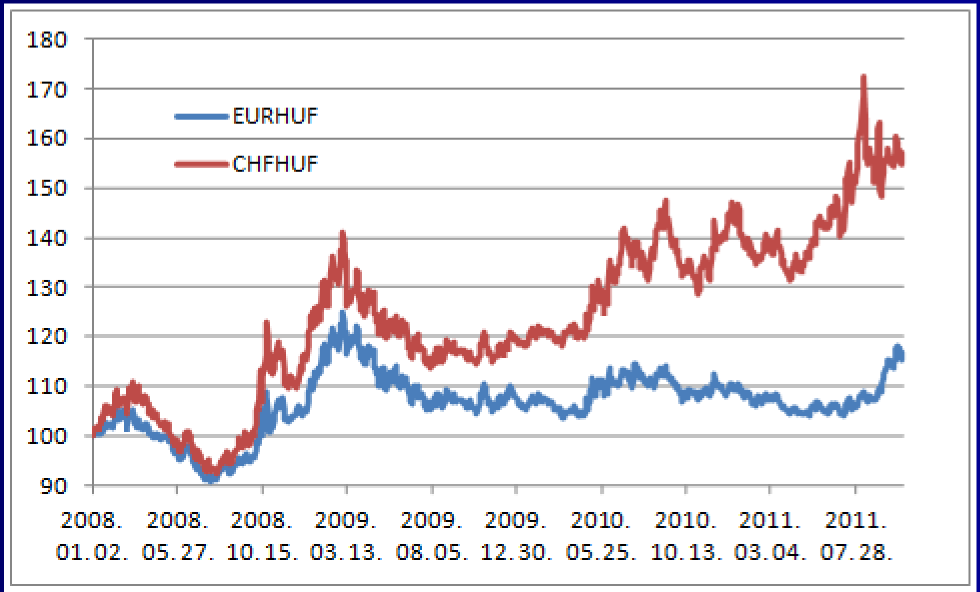
1/ "t" represents Oct 2008 for current programs, and beginning of crisis for past crises.EMs include Argentina, Brazil, Chile, China, Croatia, Czech Republic, Ecuador, India, Indonesia, Jordan, Korea, Lithuania, Malaysia, Mexico, Morocco, Peru, Poland, Russia, Thailand, Turkey, Venezuela, Vietnam.

Gross fiscal costs of banking crises

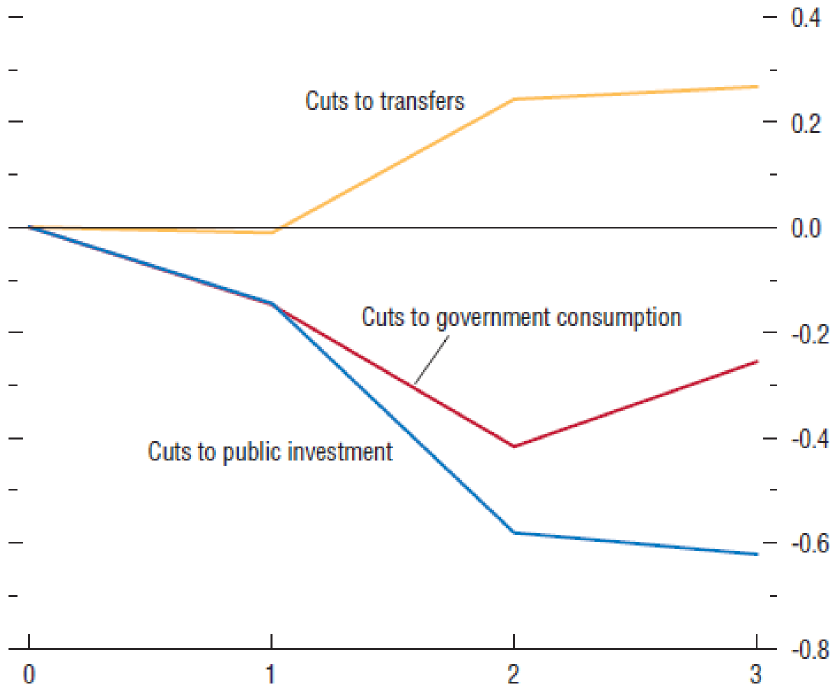



Access in
Percent of GDP
Current
Median: 7.0
Previous Crises
Median: 4.0
15
13
11
9
7
5
3
1
-1
GTM
CRI
SLV
POL
COL
MEX
MNG
BLR
PAK
LVA
ARM
SRB
BIH
ROM
GEO
UKR
HUN
ISL
ECU
BRA
PHL
THA
MEX
KOR
RUS
IDN
ARG
TUR
URY


16
14
12
10
8
6
4
1/2/2008
1/2/2009
1/2/2010
1/2/2011
3-year
5-year
10-year


180
170
160
150
140
130
120
110
100
90
EURHUF
CHFHUF
2008. 01.02.
2008. 05.27.
2008. 10.15.
2009. 03.13.
2009. 08.05.
2009. 12.30.
2010. 05.25.
2010. 10.13.
2011. 03.04.
2011. 07.28.

Impact on GDP of a 1 Percent of GDP Spending-Based Consolidation



Source: IMF staff calculations.
Note: The three lines indicate consolidation in which most of the spending cuts fell on government transfers, government consumption, and public investment, respectively. *t* = 1 denotes the year of consolidation.